Large Filing Separator Sheet

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sale price to $869.2 million. These post-closing adjustments were funded through other current liabilities at December 31, 2007 and, therefore, are included in Note 1(d), *"Summary of Significant Accounting Policies—Cash and Cash Equivalents,"* as a non-cash transaction.

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, 2008.

(Millions)	Total Amounts Committed	Payments Due By Period 2009	2010-2011	2012-2013	2014 and Thereafter
Long-term debt principal and interest payments [1]	$ 3,622.8	$ 294.1	$ 832.4	$ 728.7	$1,767.6
Operating lease obligations	47.4	11.1	18.5	13.2	4.6
Commodity purchase obligations [2]	7,260.2	3,328.6	2,036.2	911.3	984.1
Purchase orders [3]	626.8	626.5	0.3	–	–
Capital contributions to equity method investment	27.3	27.3	–	–	–
Pension and other postretirement funding obligations [4]	545.9	54.2	141.3	163.0	187.4
Total contractual cash obligations	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[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 certain pension and other postretirement benefits plans cannot be estimated beyond 2011.*

The table above does not reflect any payments related to the manufactured gas plant remediation liability of $639.0 million at December 31, 2008, as the amount and timing of payments are uncertain. See Note 15, *"Commitments and Contingencies,"* for more information about environmental liabilities. In addition, the table does not reflect any payments for the December 31, 2008, liability related to uncertain tax positions, as the amount and timing of payments are uncertain. See Note 14, *"Income Taxes,"* for more information about this liability.

Capital Requirements

Estimated construction expenditures by company for the three-year period 2009 through 2011 are listed below.

(Millions)	
WPS	
Wind generation projects	[illegible]
Environmental projects	[illegible]
Electric and natural gas distribution projects	[illegible]
Other projects	[illegible]
UPPCO	
Electric distribution projects and repairs and safety measures at hydroelectric facilities	[illegible]
MGU	
Natural gas pipe distribution system and underground natural gas storage facilities	[illegible]
MERC	
Natural gas pipe distribution system	[illegible]
PGL	
Natural gas pipe distribution system and underground natural gas storage facilities *	[illegible]
NSG	
Natural gas pipe distribution system	[illegible]
Integrys Energy Services	
Landfill methane gas project, infrastructure project, solar energy projects, and miscellaneous projects	[illegible]
IBS	
Corporate services infrastructure projects	[illegible]
Total capital expenditures	[illegible]

* *Includes approximately $55 million of expenditures related to the accelerated replacement of cast iron mains at PGL. The expenditures were initially included in a request for recovery in a rider to PGL's 2008 rate case; however, the Illinois Commerce Commission (ICC) rejected the rider. PGL again requested recovery in a rider as part of the rate case filed on February 25, 2009.*

Integrys Energy Group expects to provide additional capital contributions to ATC (not included in the above table) of approximately $27 million in 2009 and approximately $12 million in 2010. No capital contributions are expected in 2011.

All projected capital and investment expenditures are subject to periodic review and revision 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, 2008, Integrys Energy Group and each of its subsidiaries were in compliance with all respective covenants relating to outstanding short-term and long-term debt and expect to be in compliance with all such debt covenants for the foreseeable future.

Integrys Energy Group and certain of its subsidiaries' revolving credit agreements and term loans contain financial and other covenants, including but not limited to, a requirement to maintain a debt to total capitalization ratio not to exceed 65%, excluding non-recourse debt. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. Termination of the agreements could permit lenders to require immediate repayment of the outstanding borrowings thereunder.

Integrys Energy Group and certain of its subsidiaries' long-term debt obligations contain covenants related to payment of principal and interest when due and various financial reporting obligations. Failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of outstanding debt obligations.

Integrys Energy Group plans to meet its capital requirements for the period 2009 through 2011 primarily through internally generated funds, net of forecasted dividend payments, and debt and equity financings. 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. See Item 7, *"Management Discussion and Analysis, Other Future Considerations"* for additional information.

See Note 11, *"Short-Term Debt and Lines of Credit,"* for more information on our credit facilities and other short-term credit agreements.

Integrys Energy Group has the ability to publicly issue debt, equity, certain types of hybrid securities, and other financial instruments under an existing shelf registration statement, which expires in April 2009. Specific terms and conditions of securities issued will be determined prior to the actual issuance of any specific security. Integrys Energy Group's Board of Directors has authorized the issuance of up to $700.0 million of equity, debt, or other securities under this shelf registration statement, $300.0 million of which was used in December 2006 when Integrys Energy Group issued Junior Subordinated Notes. Integrys Energy Group plans to file a new shelf registration statement in the first quarter of 2009.

In May 2008, WPS filed a shelf registration statement. As a result, WPS may issue up to $250 million of senior debt securities within the next three years with amounts, prices, and terms to be determined at the time of future offerings. On December 5, 2008, WPS issued $125.0 million of 6.375%, 7-year Senior Notes under this shelf registration statement.

Other Future Considerations

Impact of Financial Market Turmoil
Volatility and uncertainty in the financial markets has impacted Integrys Energy Group in a number of ways. Due to unprecedented volatility within the global financial markets beginning in the second half of 2008, Integrys Energy Group has been exposed to increased interest costs and challenges, at times, accessing short-term capital markets. Due to disruptions in the commercial paper markets, Integrys Energy Group made draws under its syndicated revolving credit agreements for funds that would normally have been borrowed in the commercial paper market, and $300.0 million of these borrowings were outstanding at December 31, 2008. In addition, we believe that a decrease in the number of wholesale counterparties actively trading in the energy markets has reduced market liquidity and increased the risk of counterparty concentrations. This factor, combined with worsening economic conditions, has also increased the risk of credit losses. A decline in the overall level of natural gas and electricity prices has resulted in increased cash margin calls on the exchanges utilized by Integrys Energy Group for economically hedging its supply obligations.

In response to the factors discussed above, Integrys Energy Group has taken several steps to improve its available liquidity. In the fourth quarter of 2008, several transactions were closed in support of this effort. First, PGL issued $50.0 million of first mortgage bonds, and NSG issued $6.5 million of first mortgage bonds in private placement transactions. Next, Integrys Energy Group entered into an approximate $156 million drawn credit facility extending through March 2009 and entered into a $250 million undrawn credit facility extending to May 2009. Finally, WPS issued $125.0 million of 7-year fading lien first mortgage bonds. In addition to the foregoing, Integrys Energy Services has adjusted its product pricing strategy to account for the increased operating costs, collateral requirements, business risks, and potential cash margining impact. This new pricing strategy has reduced the flow of new business, therefore reducing future liquidity requirements, while improving the profitability of transactions that are executed. Management believes that these efforts have reduced its exposure to adverse market conditions. While the impact of continued market volatility and the extent and impacts of any economic downturn cannot be predicted, Integrys Energy Group currently believes it has sufficient operating flexibility and access to funding sources to maintain adequate liquidity. Also, as Integrys Energy Group heads out of the winter heating season, the natural gas storage cycle at both the regulated natural gas utilities and Integrys Energy Services will aid in the generation of positive cash flow as inventory that has been built up in storage will be sold to customers. These positive cash flows will be used to reduce short-term debt.

The recent volatility in global capital markets has also led to a reduction in the current market value of long-term investments held in Integrys Energy Group's pension and other postretirement benefit plan trusts. The recent decline in asset value of the plans will likely result in higher pension and other postretirement benefit expenses, and additional future funding requirements.

Impact of Divesting of or Scaling Back the Nonregulated Business Segment
Integrys Energy Group has made a decision to divest of its nonregulated energy services business segment, Integrys Energy Services, or reduce its size, risk, and financial requirements in response to increased collateral requirements at a time when global credit and financial markets are constraining the availability and increasing the cost of capital. As a result, Integrys Energy Services' operations will either be fully or partially divested, or scaled back to include only the most profitable products and markets, resulting in lower operating expenses and a reduced level of financial liquidity support, while invested capital will be managed downward in order to obtain an acceptable level of return. Integrys Energy Group is seeking to deploy its capital to areas with more desirable risk-adjusted rates of return.

Execution of this strategic decision will result in lower earnings capacity from this business segment going forward, although, in return, Integrys Energy Group expects an improved business risk profile and enhanced financial security. A divestiture of the nonregulated business segment, or a reduced segment scale, will also allow Integrys Energy Group to either eliminate or reduce the amount of credit facilities and other forms of financial support committed to Integrys Energy Services.

Regulatory Matters and Rate Trends

To mitigate the volatility of the price of natural gas used for electric generation, and purchased power costs in 2009 and beyond, WPS is employing risk management techniques pursuant to its PSCW-approved Risk Plan and Policy, including the use of derivative instruments such as futures and options.

On February 1, 2007, the five utilities subject to the current Wisconsin fuel rules filed proposed changes to the fuel rules with the PSCW. The primary proposed change was to implement a 1% "dead band" to limit a utility's annual exposure or opportunity to a maximum of 1% of fuel costs. The proposed "dead band" differs from the current trigger mechanism in that it would allow a utility to recover or refund all fuel costs outside of the band, rather than only those costs after the trigger date. A proposed rule for PSCW Chapter 116, "Cost of Fuel," was issued by the PSCW on July 3, 2008, incorporating many of the components of the utilities' proposal, with a 2% bandwidth as opposed to the 1% bandwidth recommended by the utilities. WPS filed comments on the proposed fuel rules, continuing to support a true "dead band" of 1%. The PSCW will need to agree on a proposed rule that will then be forwarded to the legislature for review and promulgation.

In the current political, economic, and regulatory environment, the focus on energy efficiency can lead to the implementation of decoupling mechanisms. Under decoupling, utilities are allowed to adjust rates to recover or refund the difference between the actual and authorized margin impact of variations in volumes. In the recently completed WPS rate case, the PSCW approved a settlement filed by WPS and the Wisconsin Citizens Utility Board to implement decoupling for natural gas and electric residential and small commercial sales, along with several energy efficiency initiatives. In approving the settlement, the PSCW capped the annual amount that can be recovered under the decoupling mechanism to $4.0 million for natural gas service, and $12.0 million for electric service. On January 16, 2009, WPS requested rehearing to remove or increase the decoupling caps. On February 24, 2009, in a written order, the PSCW increased the caps to $8.0 million for natural gas service and $14.0 million for electric service. Recently passed legislation in Michigan authorizes the MPSC to approve decoupling mechanisms, and in its January 2009 rate order, MGU was ordered to submit a proposal for decoupling in its next rate case filing. In Minnesota, the legislature required the Minnesota Public Utility Commission (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. Decoupling for residential and small commercial sales was approved by the ICC for PGL and NSG on a four-year trial basis on February 5, 2008, and became 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.

For a discussion of regulatory filings and decisions, see Note 23, *"Regulatory Environment."*

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 higher prices and the declining economic environment could cause more accounts receivable to become uncollectible. Higher levels of uncollectible balances would negatively impact Integrys Energy Group's results of operations and could result in higher working capital requirements.

Goodwill Impairment Testing

Integrys Energy Group performs its required annual goodwill impairment tests each April 1. SFAS No. 142, "Goodwill and Other Intangible Assets," requires goodwill to be tested on an annual basis and 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 9, *"Goodwill and Other Intangible Assets,"* for more information on goodwill balances for Integrys Energy Group's reporting units at December 31, 2008.

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. Integrys Energy Group is currently evaluating the impacts of ARRA on its financial condition, results of operations, and cash flows from operations.

In February 2009, Wisconsin Senate Bill (SB) 62 was signed into law. SB 62 contains various tax provisions intended to reduce Wisconsin's current budget gap. Integrys Energy Group is currently evaluating the impacts of SB 62 on its financial condition, results of operations, and cash flows from operations.

OFF BALANCE SHEET ARRANGEMENTS

See Note 16, *"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' marketing and trading operations manage electricity and natural gas procurement as an integrated portfolio with its retail and wholesale sales commitments. Derivative instruments are utilized in these operations.

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 entry 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, 2008.

Integrys Energy Services Mark-to-Market Roll Forward *(Millions)*	**Oil Options**	**Natural Gas**	**Electric**	**Total**
Fair value of contracts at December 31, 2007 [1]	$(0.2)	$ 89.5	$ 42.8	$132.1
Less: Contracts realized or settled during period [2]	**(0.2)**	**(68.1)**	**165.6**	**97.3**
Plus: Changes in fair value of contracts in existence at December 31, 2008 [3]	**–**	**136.4**	**(12.6)**	**123.8**
Fair value of contracts at December 31, 2008 [1]	[illegible]	[illegible]	[illegible]	[illegible]

[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.*

[2] *Includes the value of contracts in existence at December 31, 2007, that were no longer included in the net mark-to-market assets as of December 31, 2008.*

[3] *Includes unrealized gains and losses on contracts that existed at December 31, 2007, and contracts that were entered into subsequent to December 31, 2007, which were included in Integrys Energy Services' portfolio at December 31, 2008, as well as gains and losses at the inception of contracts.*

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, see Note 1(t), *"Summary of Significant Accounting Policies—Fair Value."*

Integrys Energy Services Risk Management Contract Aging at Fair Value As of December 31, 2008 *(Millions)*	**Maturity Less Than 1 Year**	**Maturity 1 to 3 Years**	**Maturity 4 to 5 Years**	**Maturity in Excess of 5 Years**	**Total Fair Value**
Fair Value Hierarchy Level					
Level 1	**$ (74.4)**	**$(34.7)**	**$ 0.5**	**$(0.5)**	**$(109.1)**
Level 2	**146.3**	**(49.6)**	**(4.5)**	**(3.4)**	**88.8**
Level 3	**76.3**	**82.6**	**12.3**	**7.7**	**178.9**
Total fair value	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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 under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. At December 31, 2008, those derivatives not designated as hedges are primarily commodity contracts used to manage price risk associated with natural gas and electricity purchase and sale activities. If the derivatives qualify for regulatory deferral subject to the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," there is no impact on income available for common shareholders prior to settlement of the contracts. In addition, Integrys Energy Group may apply the normal purchases and sales exception, provided by SFAS No. 133, as amended, to certain derivative contracts. The normal purchases and sales exception provides that recognition of gains and losses in the consolidated financial statements is not required until the settlement of the contracts.

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 foreign currency exchange rates, and 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.

Derivative contracts that are determined to fall within the scope of SFAS No. 133, as amended, are recorded at fair value on the Consolidated Balance Sheets of Integrys Energy Group. Changes in fair value, except effective portions of derivative instruments designated as hedges or qualifying for regulatory deferral, generally affect income available for common shareholders at each financial reporting date until the contracts are ultimately settled.

In conjunction with the implementation of SFAS No. 157, on January 1, 2008, Integrys Energy Group categorized its fair value measurements into three levels within a fair value hierarchy. See Note 1(t), *"Summary of Significant Accounting Policies—Fair Value,"* and Note 21, *"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, $755.4 million (25.3%) utilized Level 3 measurements. Of the total risk management liabilities, $573.4 million (19.4%) 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.

As a component of the fair value determination, 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. Under SFAS No. 157, beginning January 1, 2008, Integrys Energy Services no longer includes transaction costs in these fair value determinations, but included this in determining fair value prior to 2008. Changes in the underlying assumptions for these components of fair value at December 31, 2008, would have the following effects:

Change in Components	[illegible]
100% increase	[illegible]
50% decrease	[illegible]

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.

Purchase Accounting

The 2007 PEC merger, as well as the acquisitions of natural gas distribution operations in Michigan and Minnesota in 2006, were accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." Under this statement, the purchase price paid by the acquirer, including transaction costs, is allocated to the assets and liabilities acquired as of the acquisition date based on their fair values. The per share fair value of the common stock issued by Integrys Energy Group for the acquisition of PEC was determined by using the average market value of Integrys Energy Group's common stock over a five-day period, beginning two days before the announcement date of the merger. As Integrys Energy Group announced its intent to sell PEP at the time of the closing of the merger, the PEP assets and liabilities were reported at estimated fair value less costs to sell.

Management makes estimates of fair value based upon historical experience and information obtained from the management of the acquired company. Assumptions may be incomplete, and unanticipated events and circumstances may occur which could affect the validity of such assumptions, estimates, or actual results. As discussed below within "Asset Impairment," a significant amount of goodwill resulted from these acquisitions, which requires impairment testing on at least an annual basis. Goodwill was allocated to the various segments based on the excess of the purchase price over the estimated fair value of net identifiable assets.

In conjunction with the PEC merger, a significant fair value estimate related to nonderivative commodity contracts and customer relationships, which were recorded as intangible assets at Integrys Energy Services. The intangible asset related to the contracts is being amortized into earnings as the contracts settle, and the intangible asset related to customer relationships is being amortized over the estimated lives of those relationships. The amortization of these items had a negative impact on earnings in 2008.

PGL, NSG, MGU, and MERC are predominantly regulated utilities; therefore, in accordance with SFAS No. 71, the carrying value of the majority of their assets and liabilities approximated fair value, and as such, did not change significantly as a result of applying purchase accounting.

Asset Impairment

Integrys Energy Group reviews certain assets for impairment as required by SFAS No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets," and SFAS No. 142.

The carrying value of goodwill by segment for the year ended December 31, 2008, was:

(Millions)	[illegible]
WPS [1]	[illegible]
PGL [2]	[illegible]
NSG [2]	[illegible]
MERC [3]	[illegible]
MGU [3]	[illegible]
Total Natural Gas Segment	[illegible]
Integrys Energy Services [2]	[illegible]
Balance at December 31, 2008	[illegible]

[1] *Related to the acquisition of Wisconsin Fuel and Light in 2001.*

[2] *Related to the PEC merger in 2007.*

[3] *Related to the acquisition of the natural gas distribution operations in Michigan and Minnesota in 2006.*

The goodwill for each of our reporting units is tested for impairment annually on April 1 or more frequently when events or circumstances warrant based on the guidance of SFAS No. 142. The test for impairment includes estimating the fair market value of each reporting unit using assumptions about future profitability. Key assumptions used in the analysis include the use of an appropriate discount rate, long-term growth rates, return on equity, financial forecasts, capital expenditures, and other factors. A significant decrease in market values and/or projected future cash flows could result in an impairment loss. In 2008, an after-tax goodwill impairment loss of $6.5 million was recognized for NSG, related to a decrease in forecasted results and worsening economic factors. (See Note 9, *"Goodwill and Other Intangible Assets,"* for further discussion of the impairment.)

The review for impairment of tangible assets is more critical to Integrys Energy Services than to our other segments because of its lack of access to rate setting based on cost of service that is available to our regulated segments. At December 31, 2008, the carrying value of Integrys Energy Services' property, plant, and equipment totaled $187.5 million. Integrys Energy Group believes that the accounting estimate related to asset impairment of power plants is a "critical accounting estimate" because: (1) the estimate is susceptible to change from period to period because it requires management to make assumptions about future market sales pricing, production costs, capital expenditures, and generation volumes and (2) the impact of recognizing an impairment could be material to our financial position or results of operations. 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 estimates used at Integrys Energy Services in the impairment analyses are future revenue streams, 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 for fuel costs. These estimates are modeled over the projected remaining life of the power plants using the methodology defined in SFAS No. 144.

Integrys Energy Services 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. SFAS No. 144 requires that if the sum of the undiscounted expected future cash flows from a company's asset is less than the carrying value of the asset, an asset impairment must be recognized in the financial statements. 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).

Throughout 2008, Integrys Energy Services tested various power plants for impairment whenever events or changes in circumstances indicated that a test was required in compliance with SFAS No. 144. No material impairment charges were recorded in 2008 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

Our 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. At December 31, 2008 and 2007, Integrys Energy Group's unbilled revenues were $525.5 million and $464.7 million, respectively. Any difference between actual revenues and the estimates are recorded in revenue in the next period. Differences historically have not been significant.

With the exception of WPS, Integrys Energy Group records reserves for potential uncollectible customer accounts as an expense on the income statement and an uncollectible reserve on the balance sheet. At WPS, the PSCW follows the direct write-off approach in rates rather than the allowance method; therefore, a regulatory asset is debited rather than an expense account when the reserve for uncollectible accounts is set up. Actual write-offs at WPS are charged directly to an expense account in lieu of the reserve account. At the utilities, 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, commodity prices, and weather. Each quarter, the utilities evaluate the adequacy of the reserves for uncollectible accounts based on the most current available information and adjust the reserves for changes in estimated probable accounts receivable losses. 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. The basis for calculating the reserve for receivables from wholesale counterparties considers netting agreements, collateral, and guarantees. 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, 2008 and 2007, Integrys Energy Group's reserve for uncollectible accounts was $62.5 million and $56.0 million, respectively.

Pension and Other Postretirement Benefits

The costs of providing non-contributory defined benefit pension benefits and other postretirement benefits, described in Note 17, *"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 our regulated segments through the ratemaking process.

The following chart shows how a given change in certain actuarial assumptions would impact the projected benefit obligation and the reported annual pension cost on the income statement. 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 2008 Pension Cost**
Discount rate	(0.5)	$60.0	$1.2
Discount rate	0.5	(57.2)	(2.0)
Rate of return on plan assets	[illegible]	N/A	[illegible]
Rate of return on plan assets	[illegible]	[illegible]	[illegible]

The following chart shows how a given change in certain actuarial assumptions would impact the accumulated other postretirement benefit obligation and the reported annual other postretirement benefit cost on the income statement. 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 2008 Postretirement Benefit Cost**
Discount rate	[illegible]	$25.7	[illegible]
Discount rate	0.5	(24.2)	(2.9)
Health care cost trend rate	[illegible]	[illegible]	[illegible]
Health care cost trend rate	[illegible]	[illegible]	9.4
Rate of return on plan assets	[illegible]	N/A	[illegible]
Rate of return on plan assets	[illegible]	N/A	[illegible]

Integrys Energy Group has developed an interest rate yield curve to enable it to make judgments pursuant to Emerging Issues Task Force Topic No. D-36, "Selection of Discount Rates Used for Measuring Defined Benefit Pension Obligations and Obligations of Post Retirement Benefit Plans Other Than Pensions." 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 by Moody's as Aaa and 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 2008, 2007, and 2006. For 2008, 2007, and 2006, the actual rates of return on pension plan assets, net of fees, were (25.9%), 6.2%, and 11.3%, 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 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 previously sponsored by WPS, while differences between actual investment returns and the expected return on plan assets are recognized over a five-year period for plans previously sponsored by 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. More information on health care cost trend rates can be found in Note 17, *"Employee Benefit Plans."*

For a table showing future payments that Integrys Energy Group expects to make for pension and other postretirement benefits, see Note 17, *"Employee Benefit Plans."*

Regulatory Accounting

The electric and natural gas utility segments of Integrys Energy Group follow SFAS No. 71, and our 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 our 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 of costs is not approved or is no longer deemed probable, these regulatory assets or liabilities are recognized in current period income.

If our regulated electric and natural gas utility segments or a separable portion of those segments would no longer meet the criteria for application of SFAS No. 71, we would discontinue its application as defined under SFAS No. 101, "Regulated Enterprises—Accounting for the Discontinuation of Application of SFAS No. 71." Assets and liabilities recognized solely due to the actions of rate regulation would no longer be recognized on the balance sheet, but rather would be 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, 2008, would result in an 11.9% decrease in total assets and a 3.0% decrease in total liabilities. See Note 7, *"Regulatory Assets and Liabilities,"* for more information.

Environmental Activities Relating to Former Manufactured Gas Operations

Integrys Energy Group's utility subsidiaries, their predecessors, and certain former affiliates operated facilities in the past at multiple manufactured gas plant sites for the purpose of manufacturing gas 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 15, *"Commitments and Contingencies,"* for further discussion of environmental matters.

Tax Provision

As part of the process of preparing our Consolidated Financial Statements, we are required to estimate our income taxes for each of the jurisdictions in which we operate. This process involves estimating our 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 our Consolidated Balance Sheet. We must also assess the likelihood that our deferred tax assets will be recovered through future taxable income and, to the extent we believe that recovery is not likely, we must establish a valuation allowance, which is offset by an adjustment to income tax expense in the Consolidated Income Statements. The interpretation of tax laws involves uncertainty, since tax authorities may interpret them differently. As of January 1, 2007, we adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FAS 109." As allowed under Interpretation No. 48, Integrys Energy Group elected to change its method of accounting to record interest and penalties paid on income tax obligations as a component of income tax expense.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our deferred tax assets. The assumptions involved are supported by historical data, reasonable projections, and technical interpretations of applicable tax law and regulation 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 Notes 1(p) *"Income Taxes,"* and 14, *"Income Taxes,"* for a discussion of accounting for income taxes.

IMPACT OF INFLATION

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and report operating results in terms of historic cost. The statements provide a reasonable, objective, and quantifiable statement of financial results, but they do not evaluate the impact of inflation. For our regulated operations, to the extent we are not recovering the effects of inflation, we will file rate cases as necessary in the various jurisdictions. Our nonregulated businesses include inflation in forecasted costs.

CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 *(Millions, except per share data)*	2008	2007	2006
Nonregulated revenue	$ 9,787.9	$ 6,987.0	$5,156.7
Utility revenue	4,259.9	3,305.4	1,734.0
Total revenues	14,047.8	10,292.4	6,890.7
Nonregulated cost of fuel, natural gas, and purchased power	9,484.3	6,676.2	4,968.9
Utility cost of fuel, natural gas, and purchased power	2,744.1	2,044.2	1,006.1
Operating and maintenance expense	1,061.2	922.1	484.3
Goodwill impairment loss	6.5	–	–
Depreciation and amortization expense	221.4	195.1	121.3
Taxes other than income taxes	93.6	87.4	60.9
Operating income	246.7	367.4	249.2
Miscellaneous income	87.3	64.1	42.8
Interest expense	(158.1)	(164.5)	(99.2)
Minority interest	0.1	0.1	3.8
Other expense	(70.7)	(100.3)	(52.6)
Income before taxes	176.0	267.1	196.6
Provision for income taxes	51.2	86.0	45.0
Income from continuing operations	124.8	181.1	151.6
Discontinued operations, net of tax	4.7	73.3	7.3
Income before preferred stock dividends of subsidiary	129.5	254.4	158.9
Preferred stock dividends of subsidiary	3.1	3.1	3.1
Income available for common shareholders	$ 126.4	$ 251.3	$ 155.8
Average shares of common stock			
Basic	76.7	71.6	42.3
Diluted	77.0	71.8	42.4
Earnings per common share (basic)			
Income from continuing operations	$1.59	$2.49	$3.51
Discontinued operations, net of tax	0.06	1.02	0.17
Earnings per common share (basic)	$1.65	$3.51	$3.68
Earnings per common share (diluted)			
Income from continuing operations	$1.58	$2.48	$3.50
Discontinued operations, net of tax	0.06	1.02	0.17
Earnings per common share (diluted)	$1.64	$3.50	$3.67
Dividends per common share	[illegible]	$2.56	$2.28

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

CONSOLIDATED BALANCE SHEETS

At December 31 *(Millions)*	2008	2007
Assets		
Cash and cash equivalents	$ 254.1	$ 41.2
Accounts receivable and accrued unbilled revenues, net of reserves of $62.5 and $56.0, respectively	2,155.3	1,870.0
Inventories	732.9	663.4
Assets from risk management activities	2,223.7	840.7
Regulatory assets	244.0	141.7
Other current assets	280.8	169.3
Current assets	5,890.8	3,726.3
Property, plant, and equipment, net of accumulated depreciation of $2,710.0 and $2,602.2, respectively	4,773.3	4,463.8
Regulatory assets	1,444.8	1,102.3
Assets from risk management activities	758.7	459.3
Goodwill	933.9	948.3
Pension assets	–	101.4
Other	471.0	433.0
Total assets	$14,272.5	$11,234.4
Liabilities and Shareholders' Equity		
Short-term debt	$ 1,209.0	$ 468.2
Current portion of long-term debt	155.2	55.2
Accounts payable	1,534.3	1,331.8
Liabilities from risk management activities	2,190.3	813.5
Regulatory liabilities	58.8	77.9
Deferred income taxes	71.6	13.9
Other current liabilities	494.8	487.7
Current liabilities	5,714.0	3,248.2
Long-term debt	2,288.0	2,265.1
Deferred income taxes	435.7	494.4
Deferred investment tax credits	36.9	38.3
Regulatory liabilities	275.5	292.4
Environmental remediation liabilities	640.6	705.6
Pension and other postretirement benefit obligations	634.5	247.9
Liabilities from risk management activities	762.7	372.0
Asset retirement obligations	179.1	140.2
Other	152.8	143.4
Long-term liabilities	5,407.8	4,699.3
Commitments and contingencies		
Preferred stock of subsidiary with no mandatory redemption – $100 par value; 1,000,000 shares authorized; 511,882 shares issued; 510,516 shares outstanding	51.1	51.1
Common stock – $1 par value; 200,000,000 shares authorized; 76,430,037 shares issued; 75,992,768 shares outstanding	76.4	76.4
Additional paid-in capital	2,487.9	2,473.8
Retained earnings	624.6	701.9
Accumulated other comprehensive loss	(72.8)	(1.3)
Treasury stock and shares in deferred compensation trust	(16.5)	(15.0)
Total liabilities and shareholders' equity	$14,272.5	$11,234.4

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

CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDERS' EQUITY

							Accumulated Other Comprehensive Income (Loss)				
(Millions)	Total	Deferred Compensation Trust	Common Stock	Additional Paid in Capital	Retained Earnings	Treasury Stock	Cash Flow Hedges	Minimum Pension Liability	SFAS 158 Pension Costs	Available For Sale Securities	Foreign Currency Translation
Balance at December 31, 2005	$1,304.2	$(10.9)	$40.1	$ 717.0	$568.7	$(0.3)	$ (7.6)	$(3.8)	$ –	$0.6	$0.4
Income available for common shareholders	155.8	–	–	–	155.8	–	–	–	–	–	–
Other Comprensive Income											
Net unrealized (losses) on cash flow hedges (net of tax of $11.9)	(18.0)	–	–	–	–	–	(18.0)	–	–	–	–
Reclassification into earnings from cash flow hedges (net of tax of $11.4)	17.4	–	–	–	–	–	17.4	–	–	–	–
Minimum pension liability (net of tax of $1.6)	2.4	–	–	–	–	–	–	2.4	–	–	–
Available for sale securities (net of tax of $0.2)	(0.4)	–	–	–	–	–	–	–	–	(0.4)	–
Foreign currency translation (net of tax of $0.2)	(0.3)	–	–	–	–	–	–	–	–	–	(0.3)
Comprehensive income	156.9	–	–	–	–	–	–	–	–	–	–
Issuance of common stock	164.6	–	3.2	161.4	–	–	–	–	–	–	–
Dividends on common stock	(96.0)	–	–	–	(96.0)	–	–	–	–	–	–
Adjustment to initially apply SFAS No. 158 (net of taxes of $2.9)	(4.5)	–	–	–	–	–	–	1.4	(5.9)	–	–
Other	8.4	(2.3)	0.1	10.9	(0.3)	–	–	–	–	–	–
Balance at December 31, 2006	$1,533.6	$(13.2)	$43.4	$ 889.3	$628.2	$(0.3)	$ (8.2)	$ –	$ (5.9)	$0.2	$0.1
Income available for common shareholders	251.3	–	–	–	251.3	–	–	–	–	–	–
Other Comprensive Income											
Net unrealized (losses) on cash flow hedges (net of tax of $11.9)	(18.4)	–	–	–	–	–	(18.4)	–	–	–	–
Reclassification into earnings from cash flow hedges (net of tax of $15.0)	23.3	–	–	–	–	–	23.3	–	–	–	–
SFAS No. 158 unrecognized pension costs (net of taxes of $3.0)	3.8	–	–	–	–	–	–	–	3.8	–	–
Available for sale securities (net of tax of $0.2)	0.4	–	–	–	–	–	–	–	–	0.4	–
Foreign currency translation (net of tax of $2.2)	3.6	–	–	–	–	–	–	–	–	–	3.6
Comprehensive income	264.0	–	–	–	–	–	–	–	–	–	–
Issuance of common stock	45.6	–	1.1	44.5	–	–	–	–	–	–	–
Peoples Energy Corporation merger	1,559.3	–	31.9	1,527.4	–	–	–	–	–	–	–
Stock based compensation	8.7	–	–	8.7	–	–	–	–	–	–	–
Dividends on common stock	(177.0)	–	–	–	(177.0)	–	–	–	–	–	–
Other	1.6	(1.5)	–	3.9	(0.6)	–	(0.3)	–	–	–	0.1
Balance at December 31, 2007	$3,235.8	$(14.7)	$76.4	$2,473.8	$701.9	$(0.3)	$ (3.6)	$ –	$ (2.1)	$0.6	$3.8
Income available for common shareholders	**126.4**	–	–	–	**126.4**	–	–	–	–	–	–
Other Comprensive Income											
Net unrealized (losses) on cash flow hedges (net of tax of $53.7)	**(84.0)**	–	–	–	–	–	**(84.0)**	–	–	–	–
Reclassification into earnings from cash flow hedges (net of tax of $20.0)	**31.2**	–	–	–	–	–	**31.2**	–	–	–	–
SFAS No. 158 unrecognized pension costs (net of taxes of $8.1)	**(12.7)**	–	–	–	–	–	–	–	**(12.7)**	–	–
Available for sale securities (net of tax of $0.3)	**(0.5)**	–	–	–	–	–	–	–	–	**(0.5)**	–
Foreign currency translation (net of tax of $3.4)	**(5.5)**	–	–	–	–	–	–	–	–	–	**(5.5)**
Comprehensive income	**54.9**	–	–	–	–	–	–	–	–	–	–
Cumulative effect of change in accounting principle	**4.5**	–	–	–	**4.5**	–	–	–	–	–	–
Effects of changing pension plan measurement date pursuant to SFAS No. 158	**(3.5)**	–	–	–	**(3.5)**	–	–	–	–	–	–
Purchase of deferred compensation shares	**(2.7)**	**(2.7)**	–	–	–	–	–	–	–	–	–
Stock based compensation	**12.6**	–	–	**12.5**	–	**0.1**	–	–	–	–	–
Dividends on common stock	**(203.9)**	–	–	–	**(203.9)**	–	–	–	–	–	–
Other	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Balance at December 31, 2008	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31 *(Millions)*	2008	2007	2006
Operating Activities			
Income before preferred stock dividends of subsidiary	$129.5	$254.4	$ 158.9
Adjustments to reconcile income before preferred stock dividends of subsidiary to net cash (used for) provided by operating activities			
Discontinued operations, net of tax	(4.2)	(73.3)	(7.3)
Goodwill impairment loss	6.5	–	–
Depreciation and amortization expense	321.4	195.1	121.3
Refund of nonqualified decommissioning trust	(0.5)	(70.6)	(54.5)
Weston 3 outage expenses	0.4	(22.7)	–
Recovery of Midwest Independent Transmission System Operator, Inc. (MISO) Day 2 expenses	19.8	–	–
Recoveries and refunds of other regulatory assets and liabilities	31.4	32.6	15.2
Amortization of nonregulated customer contract intangibles	13.3	21.0	–
Net unrealized (gains) losses on nonregulated energy contracts	(15.4)	(59.5)	7.3
Nonregulated lower of cost or market inventory adjustments	167.3	7.0	0.9
Bad debt expense	74.8	39.1	10.9
Pension and other postretirement expense	59.7	67.5	51.6
Pension and other postretirement funding	(80.8)	(35.3)	(43.2)
Deferred income taxes and investment tax credit	62.4	66.8	12.4
Gain on sale of investments	–	(2.7)	(21.6)
(Gain) loss on sale of property, plant, and equipment	(1.2)	1.1	1.3
Equity income, net of dividends	(15.1)	2.4	14.4
Other	(3.9)	(22.5)	22.8
Changes in working capital			
Receivables and unbilled revenues, net	(446.9)	51.3	(19.4)
Inventories	(312.0)	(172.9)	(206.5)
Other current assets	(124.6)	0.9	(32.4)
Accounts payable	(53.2)	(96.5)	7.5
Other current liabilities	(10.8)	55.3	33.3
Net cash (used for) provided by operating activities	(280.8)	238.5	72.9
Investing Activities			
Capital expenditures	(532.8)	(392.6)	(342.0)
Proceeds from sale or disposal of property, plant, and equipment	31.1	15.6	4.5
Purchase of equity investments and other acquisitions	(37.8)	(66.5)	(60.1)
Proceeds from the sale of investments	–	–	58.4
Cash paid for transaction costs related to Peoples Energy Corporation merger	–	(14.4)	(5.5)
Acquisition of natural gas operations in Michigan and Minnesota, net of liabilities assumed	–	1.9	(659.3)
Restricted cash for repayment of long-term debt	–	22.0	(22.0)
Cash paid for transmission interconnection	(17.4)	(23.9)	(11.6)
Proceeds received from transmission interconnection	99.2	–	–
Other	5.0	6.4	7.5
Net cash used for investing activities	(492.3)	(451.5)	(1,030.1)
Financing Activities			
Short-term debt, net	549.2	(463.7)	458.0
Issuance of notes payable	193.7	–	–
Proceeds from sale of borrowed natural gas	530.4	211.9	197.0
Purchase of natural gas to repay natural gas loans	(257.2)	(177.5)	(265.4)
Issuance of long-term debt	161.5	125.2	447.0
Repayment of long-term debt	(58.1)	(26.5)	(4.0)
Payment of dividends			
Preferred stock	(3.1)	(3.1)	(3.1)
Common stock	(209.9)	(177.0)	(96.0)
Issuance of common stock	–	45.6	164.6
Other	(3.7)	5.9	(6.4)
Net cash provided by (used for) financing activities	911.3	(459.2)	891.7
Change in cash and cash equivalents – continuing operations	209.1	(672.2)	(65.5)
Change in cash and cash equivalents – discontinued operations			
Net cash (used for) provided by operating activities	–	(109.3)	41.9
Net cash provided by investing activities	3.8	799.5	19.1
Change in cash and cash equivalents	212.9	18.0	(4.5)
Cash and cash equivalents at beginning of year	41.2	23.2	27.7
Cash and cash equivalents at end of year	[illegible]	$ 41.2	$ 23.2

The accompanying notes to Integrys Energy Group's consolidated financial statements are an integral part of these 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, 2008, included Wisconsin Public Service Corporation (WPS), Upper Peninsula Power Company (UPPCO), Michigan Gas Utilities Corporation (MGU), Minnesota Energy Resources Corporation (MERC), The Peoples Gas Light and Coke Company (PGL), North Shore Gas Company (NSG), and Integrys Energy Services. Of these subsidiaries, six subsidiaries are regulated electric and/or natural gas utilities and one subsidiary, Integrys Energy Services, is a nonregulated energy supply and services company.

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 line item on the Consolidated Statements of Income titled "Income available for common shareholders" is net income.

(b) Consolidation 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 minority owner's equity is reduced to zero, our policy is to record 100% of the subsidiary's losses until the minority 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 owns less than 20% of the voting equity of a company, unless other evidence indicates we have significant influence over the operating and financial policies of the investee. Investments in businesses not controlled by Integrys Energy Group, but over which we have significant influence regarding the operating and financial policies of the investee, are accounted for using the equity method. For additional information on our equity method investments see Note 8, "*Investments in Affiliates, at Equity Method.*"

<u>Mergers and Acquisitions</u>
Effective February 21, 2007, the Peoples Energy Corporation (PEC) merger was consummated and the assets and liabilities, results of operations, and cash flows of PEC were included in Integrys Energy Group's Consolidated Financial Statements commencing February 22, 2007. See Note 5, "*Acquisitions and Dispositions,*" for more information.

The assets and liabilities, results of operations, and cash flows of MGU and MERC were included in Integrys Energy Group's Consolidated Financial Statements effective April 1, and July 1, 2006, respectively. See Note 5, "*Acquisitions and Dispositions,*" for more information.

<u>Dispositions</u>
A contingent payment made by the buyer of Integrys Energy Services' Stoneman generation facility resulted in a gain that was recorded as a component of discontinued operations in the fourth quarter of 2008. See Note 3, "*Discontinued Operations,*" for more information.

Peoples Energy Production Company's (PEP's) results of operations and cash flows are reported in discontinued operations in 2007. The sale of PEP was completed on September 28, 2007. Refer to Note 3, "*Discontinued Operations,*" for more information.

For all applicable periods presented, Sunbury (sold in 2006) and Niagara (sold in 2007) have been reclassified as held for sale, and results of operations and cash flows for these entities have been reclassified as discontinued operations. Refer to Note 3, "*Discontinued Operations,*" for more information.

(c) Use of Estimates—We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. We make 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)	2007	2006
Cash paid for interest	$144.5	$87.6
Cash paid for income taxes	198.1	37.7

Significant non-cash transactions were:

(Millions)	2007	2006
Construction costs funded through accounts payable	$ 26.1	$32.0
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	-
Transaction costs related to the merger with PEC funded through other current liabilities	-	8.1

(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, 2008, and 2007, Integrys Energy Group's unbilled revenues were $525.5 million and $464.7 million, respectively. Currently there are no customers or industries that account 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 all 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 Public Service Commission of Wisconsin (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 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.

Revenues related to derivative instruments classified as trading are reported net of related cost of sales for all periods presented.

In connection with the March 2006 settlement of Natural Gas Charge proceedings for fiscal years 2001 through 2004, PGL now nets revenues against expenses from natural gas hub services, resulting in a credit to utility customers' natural gas charges.

Integrys Energy Group presents revenue 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 our regulated segments, 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 last-in, first-out (LIFO) cost method. Inventories stated on a LIFO basis represent approximately 16% of total inventories at December 31, 2008, and 14% of total inventories at December 31, 2007. The estimated replacement cost of natural gas in inventory at December 31, 2008, and December 31, 2007, exceeded the LIFO cost by approximately $212.2 million and $304.4 million, respectively. In calculating these replacement amounts, PGL and NSG used a Chicago city-gate natural gas price per dekatherm of $5.80 at December 31, 2008, and $7.33 at December 31, 2007.

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.

(g) Risk Management Activities—As part of our 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, interest rates, and foreign currency exchange 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 policies approved by Integrys Energy Group's Board of Directors and, if applicable, by the respective regulators.

Integrys Energy Group accounts for derivative instruments pursuant to Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted. Under the provisions of SFAS No. 133, all derivatives are recognized on the balance sheet at their fair value unless they qualify for the normal purchases and sales exception. Most energy-related physical and financial derivatives in our regulated operations qualify for regulatory deferral subject to the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." These derivatives are marked to fair value pursuant to SFAS No. 133 and are offset with a corresponding regulatory asset or liability. Management believes any gains or losses resulting from the eventual settlement of these derivative instruments will be collected from or refunded to customers.

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 revenues. 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.

Financial Accounting Standards Board (FASB) Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts," as amended, 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 reflected in accounts receivable, 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 in SFAS No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets," 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 generally returned to ratepayers.

(i) Property, Plant, and Equipment—Utility plant is stated at the original cost of construction, including Allowance for Funds Used During Construction (AFUDC). 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 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, with removal costs charged against the liability as incurred.

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	2007	2006
WPS – Electric	3.35%	3.36%
WPS – Natural gas	3.52%	3.57%
UPPCO	3.01%	2.90%
MGU	2.67%	2.06% (1)
MERC	3.42%	1.76% (2)
PGL	2.86% (3)	–
NSG	1.85% (3)	–

(1) *Composite depreciation rate for 9 months of the year.*
(2) *Composite depreciation rate for 6 months of the year.*
(3) *Composite depreciation rate from February 22, 2007, through the end of 2007.*

Interest capitalization is applied to nonutility property during construction, and a gain and loss is recognized for retirements. Currently, nonutility property at the regulated utilities consists primarily of land.

Nonregulated plant is stated at cost, which includes capitalized interest, or estimated fair value at the time of acquisition. 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.

Most of the nonregulated subsidiaries compute depreciation using the straight-line method over the following estimated useful lives:

Structures and improvements	15 to 40 years
Office and plant equipment	5 to 40 years
Office furniture and fixtures	3 to 10 years
Vehicles	5 years
Computer equipment	3 to 8 years
Leasehold improvements	Shorter of: life of the lease or life of the asset

The nonregulated Combined Locks Energy Center uses the units of production depreciation method for selected components of equipment having defined lives stated in terms of hours of production.

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.

See Note 4, *"Property, Plant, and Equipment,"* for details regarding Integrys Energy Group's property, plant, and equipment balances.

(j) Capitalized Interest and AFUDC—Our nonregulated subsidiaries capitalize interest for construction projects, while our utilities capitalize the cost of funds used for construction using a calculation that includes both internal equity and external debt components, as required by regulatory accounting. 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 2008, WPS's average AFUDC retail rate was 8.61%. WPS's construction work in progress average AFUDC wholesale rate was 8.04%. WPS's allowance for equity funds used during construction for 2008, 2007, and 2006 was $5.2 million, $0.9 million, and $0.6 million, respectively. WPS's allowance for borrowed funds used during construction for 2008, 2007, and 2006 was $1.8 million, $0.3 million, and $0.2 million, respectively.

The AFUDC calculation for the other utilities is determined by the respective state commissions, each with specific requirements. Based on these requirements, the other utilities did not record significant AFUDC for 2008, 2007, or 2006.

The interest rate capitalized on long-term construction at our nonregulated subsidiaries is based upon the monthly short-term borrowing rate Integrys Energy Group incurs for such funds. The nonregulated subsidiaries had no significant interest capitalized during 2008, 2007, and 2006.

(k) Regulatory Assets and Liabilities—The regulated electric and natural gas utility segments of Integrys Energy Group are subject to the provisions of SFAS No. 71. 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 7, *"Regulatory Assets and Liabilities,"* for more information.

(l) Asset Impairment—We review the recoverability of long-lived tangible and intangible assets in accordance with SFAS No. 144. This statement requires review of assets when events or circumstances indicate that the carrying amount may not be recoverable. We base our evaluation on the presence of impairment indicators such as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, and other external market conditions or factors.

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 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) Goodwill and Other Intangible Assets—In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and other intangible assets with indefinite lives are not amortized, but are subject to an annual impairment test. WPS, MGU, MERC, PGL, NSG, and Integrys Energy Services, our reporting units with goodwill, perform their annual goodwill impairment tests during the second quarter of each year. Interim impairment tests are performed whenever events or changes in circumstances indicate that the asset might be impaired.

Other intangible assets with definite lives consist primarily of emission allowances, customer related intangible assets, and customer contract assets and liabilities. The impairment testing for these intangible assets is performed in accordance with SFAS No. 144 and is discussed in Note 1(l), *"Summary of Significant Accounting Policies – Asset Impairment."*

For more information on Integrys Energy Group's goodwill and other intangible assets, see Note 9, *"Goodwill and Other Intangible Assets."*

(n) 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.

(o) Asset Retirement Obligations—Integrys Energy Group applies SFAS No. 143, "Accounting for Asset Retirement Obligations," and FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations." Under these accounting standards, 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 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 13, *"Asset Retirement Obligations,"* for more information.

(p) Income Taxes—We account for income taxes using the liability method as prescribed by SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred income taxes have been recorded using currently enacted tax rates for the differences between the tax basis of assets and liabilities and the basis reported in the financial statements. Our regulated utilities are allowed to defer certain adjustments made to income taxes and record regulatory assets or liabilities related to these adjustments.

Integrys Energy Group adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FAS 109," on January 1, 2007. As a result of the implementation of Interpretation No. 48, Integrys Energy Group recognized a $0.1 million decrease in the liability for unrecognized tax benefits, which was accounted for as an increase in the January 1, 2007, balance of retained earnings.

Investment tax credits that reduce our income taxes payable for the current year are eligible for carryover and are recognized as a reduction of income tax expense if the credits are generated in our nonregulated operations. We do not reduce our current year income tax expense if it is likely that we will sell the related property that generated the tax credits after the end of the year and the tax credits would also be transferred to the seller as permitted under tax law. For credits generated in our regulated operations that apply SFAS No. 71, our regulators reduce our future rates over the lives of the property to which the tax credits relate; accordingly, we defer the investment tax credits in the year our taxes payable are reduced and we reduce income tax expense over the useful lives of the related property.

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 income tax provision 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.

For more information regarding Integrys Energy Group's accounting for income taxes, see Note 14, *"Income Taxes."*

(q) Guarantees—Integrys Energy Group applies Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of Indebtedness of Others," 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 16, *"Guarantees."*

(r) 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 previously sponsored by WPS, while differences between actual investment returns and the expected return on plan assets are recognized over a five-year period for plans previously sponsored by 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 United States Generally Accepted Accounting Principles (GAAP).

Integrys Energy Group adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)," at December 31, 2006. SFAS No. 158 requires employers to recognize a defined benefit postretirement plan's funded status in the balance sheet, and recognize changes in the plan's funded status in other comprehensive income in the year in which the changes occur. Integrys Energy Group's regulated utilities record changes in the funded status to regulatory asset or liability accounts, pursuant to SFAS No. 71.

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 17, *"Employee Benefit Plans."*

(s) Stock-Based Employee Compensation—Integrys Energy Group has stock-based employee compensation plans, which are described more fully in Note 20, *"Stock-Based Compensation."* Effective January 1, 2006, Integrys Energy Group adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment," using the modified prospective transition method. Under this transition method, prior periods' results were not restated. Stock-based compensation cost for 2006 included compensation cost for all stock-based compensation awards granted prior to, but not yet fully vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, adjusted for estimated future forfeitures. The fair values of stock-based compensation awards granted after January 1, 2006, were estimated in accordance with the provisions of SFAS No. 123(R). The cumulative effect of a change in accounting principle recorded upon adoption of SFAS No. 123(R) was not significant.

(t) Fair Value—Effective January 1, 2008, Integrys Energy Group adopted SFAS No. 157, "Fair Value Measurements." This standard defines fair value and requires enhanced disclosures about assets and liabilities carried at fair value. As of December 31, 2008, these additional disclosures are required only for financial assets and liabilities measured at fair value and for nonfinancial assets and liabilities measured at fair value on a recurring basis, following the guidance in FASB Staff Position FAS 157-2, "Effective Date of FASB Statement No. 157." These disclosures can be found in Note 21, *"Fair Value."*

SFAS No. 157 requires that a fair value measurement 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. SFAS No. 157 also specifies that transaction costs should not be considered in the determination of fair value. On January 1, 2008, Integrys Energy Group recognized an increase to 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 provides 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.

In conjunction with the implementation of SFAS No. 157, Integrys Energy Services determined that the unit of account for its derivative instruments is the individual contract level; accordingly, these contracts are now presented on the Consolidated Balance Sheets as assets or liabilities based on the nature of the individual contract.

According to SFAS No. 157, 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). As permitted under SFAS No. 157, 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 establishes 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 defined by SFAS No. 157 are 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 best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs.

As required by SFAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

(u) New Accounting Pronouncements—In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." SFAS No. 141(R) provides greater consistency in the accounting for and financial reporting of business combinations. Among other changes, the standard will require the following: (1) all assets acquired and liabilities assumed must be recognized at the transaction date, including those related to contractual contingencies, (2) transaction costs and restructuring costs that the acquirer expects, but is not obligated, to incur are to be expensed, (3) changes to deferred tax benefits as a result of the business combination must be recognized immediately in income from continuing operations or equity, depending on the circumstances, and (4) in a bargain purchase, a gain is to be recorded instead of writing down fixed assets. Certain new disclosure requirements will enable the evaluation of the nature and financial effect of the business combination. SFAS No. 141(R) is effective for business combinations consummated after January 1, 2009. Also effective January 1, 2009, any adjustments to uncertain tax positions from business combinations consummated prior to January 1, 2009, will no longer be recorded as an adjustment to goodwill, but will be reported in income.

SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements," was issued in December 2007. This standard changes the accounting and reporting related to noncontrolling interests and requires, among other things, that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income. This standard is effective for Integrys Energy Group for the period ending March 31, 2009. Integrys Energy Group expects this standard to change the presentation of the preferred stock dividends of its subsidiary on its Consolidated Statements of Income.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." SFAS No. 161 requires enhanced disclosures about (1) how and why an entity uses derivative instruments, (2) how derivative instruments and related hedged items are accounted for under SFAS No. 133, as amended, and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for Integrys Energy Group for the reporting period ending March 31, 2009, and will result in expanded disclosures for derivative instruments.

FASB Staff Position (FSP) No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities," was issued in June 2008. This FSP clarifies that unvested stock-based compensation awards with rights to dividends or dividend equivalents that cannot be forfeited are to be included in the basic earnings per share calculation using the two-class method defined in SFAS No. 128, "Earnings per Share." This FSP is effective for Integrys Energy Group for the quarter ending March 31, 2009. The guidance must be applied retrospectively. We do not expect this FSP to have a significant impact on basic earnings per share.

Emerging Issues Task Force (EITF) Issue No. 08-6, "Equity Method Investment Accounting Considerations," was ratified in November 2008. Issue No. 08-6 is intended to clarify the application of the equity method of accounting following adoption of SFAS No. 141(R). According to the guidance, the initial carrying value of an equity method investment should include transaction costs; an other-than-temporary impairment test should be performed on the overall investment, rather than on the underlying indefinite-lived intangible assets; the equity method investee's issuance of shares should be accounted for as the sale of a proportionate share of the investment; and no gain or loss should be recognized when changing the method of accounting for an investment from the equity method to the cost method. This EITF Issue is effective for Integrys Energy Group for the quarter ending March 31, 2009. Integrys Energy Group does not expect EITF Issue No. 08-6 to have a significant impact on its financial statements.

FSP No. FAS 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets," was issued in December 2008. This FSP amends SFAS No. 132(R), "Employers' Disclosures about Pensions and Other Postretirement Benefits," and requires additional disclosures about plan assets. These disclosures include: a description of investment policies and strategies, disclosures of the fair value of each major category of plan assets, information about the fair value measurements of plan assets, and disclosures about significant concentrations of risk in plan assets. This FSP is effective for Integrys Energy Group for the reporting period ending December 31, 2009, and will result in expanded disclosures related to postretirement benefit plan assets.

NOTE 2—RISK MANAGEMENT ACTIVITIES

The following table shows Integrys Energy Group's assets and liabilities from risk management activities as of December 31, 2008, and 2007:

	Assets		Liabilities	
(Millions)	**2008**	2007	**2008**	2007
Utility Segments				
Commodity contracts	**$ 21.4**	$ 8.2	**$ 166.4**	$ 30.4
Financial transmission rights	**7.2**	13.4	**4.2**	4.4
Cash flow hedges – commodity contracts	**–**	–	**1.5**	0.3
Nonregulated Segments				
Commodity and foreign currency contracts	**2,836.2**	1,241.4	**2,681.6**	1,125.7
Fair value hedges				
Commodity contracts	**14.2**	7.4	**–**	2.0
Interest rate swaps	**3.2**	–	**–**	0.3
Cash flow hedges				
Commodity contracts	**85.4**	29.6	**94.2**	18.3
Interest rate swaps	**–**	–	**5.1**	4.1
Foreign currency	**14.8**	–	**–**	–
Total	**$2,982.4**	$1,300.0	**$2,953.0**	$1,185.5
Balance Sheet Presentation				
Current	**$2,253.7**	$ 840.7	**$2,190.3**	$ 813.5
Long-term	**728.7**	459.3	**762.7**	372.0
Total	[illegible]	$1,300.0	[illegible]	$1,185.5

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

Utility Segments

The derivatives listed in the above table as "commodity contracts" include natural gas purchase contracts as well as financial derivative contracts (New York Mercantile Exchange (NYMEX) futures, options, and swaps) used by both the electric and natural gas utility segments to mitigate the risk associated with market price volatility of natural gas. The electric utility segment also uses financial instruments to manage transmission congestion costs, which are shown in the above table as "financial transmission rights."

Nonregulated Segments

The derivatives in the nonregulated segments not designated as hedges under GAAP are primarily commodity contracts used to manage price risk associated with natural gas and electric energy purchase and sale activities and foreign currency contracts used to manage foreign currency exposure. Changes in the fair value of non-hedge derivatives are recognized currently in earnings.

In the second quarter of 2006, Integrys Energy Services began entering into a limited number of derivative energy contracts with terms that extended as long as 12 years. Observable market data was not available for the longer-dated portion, generally periods greater than five years (the unobservable periods), of these contracts at the time and, therefore, Integrys Energy Services had valued the unobservable periods of these contracts at zero. In the third quarter of 2007, Integrys Energy Services determined that this approach was inappropriate under GAAP and began to use internally developed pricing data to estimate the fair value of such unobservable periods. The cumulative effect related to prior periods was an increase in income from continuing operations and income available for common shareholders of $4.6 million, net of taxes. Management determined that this amount was not material to prior periods. The determination of fair value for these derivative contracts is subjective and requires significant management judgment.

Integrys Energy Services also enters into commodity derivative contracts that are designated as either fair value or cash flow hedges. Integrys Energy Services uses fair value hedges to mitigate the risk of changes in the price of natural gas held in storage. Fair value hedge ineffectiveness was not significant in 2008 and 2007, and was a pre-tax gain of $3.7 million in 2006. 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 and 2006.

Commodity contracts 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. Cash flow hedge ineffectiveness related to commodity contracts was not significant during 2008, was a pre-tax loss of $4.4 million in 2007, and was a pre-tax gain of $8.6 million in 2006. When testing for effectiveness, no portion of the derivative instruments was excluded. Amounts recorded in other comprehensive income related to these cash flow hedges will be recognized in earnings when the hedged transactions occur, which is typically as the related contracts are settled, or if it is probable that the hedged transaction will not occur. The amount reclassified from other comprehensive income into earnings as a result of the discontinuance of cash flow hedge accounting for certain hedge transactions was a pre-tax loss of $2.7 million during 2008, was not significant during 2007, and was a pre-tax gain of $2.1 million in 2006. In the next 12 months, subject to changes in market prices of natural gas and electricity, we expect that a pre-tax loss of $72.8 million will be recognized in earnings as the hedged transactions occur. We expect this amount to be substantially offset by settlement of the related nonderivative contracts that are being hedged.

In November 2008, Integrys Energy Group designated as cash flow hedges two forward foreign currency exchange contracts entered into to hedge the variability in the foreign currency exposure of a fixed rate Japanese yen denominated term loan that matures on March 30, 2009. Cash flow hedge ineffectiveness recorded in nonregulated revenue related to this transaction was not significant during 2008.

Integrys Energy Group's Cash Collateral Positions

(Millions)	[illegible]	**December 31, 2007**
Cash collateral provided to others	[illegible]	$23.5
Cash collateral received from others	[illegible]	49.1

NOTE 3—DISCONTINUED OPERATIONS

Stoneman

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

PEP

In September 2007, Integrys Energy Group completed the sale of PEP, an oil and natural gas production subsidiary acquired in the PEC merger, for $869.2 million, net of certain post-closing adjustments. These post-closing adjustments were funded through other current liabilities at December 31, 2007 and, therefore, are included in Note 1(d), *"Summary of Significant Accounting Policies – Cash and Cash Equivalents,"* as a non-cash transaction for 2007. Including the impact of the post-closing adjustments, the pre-tax gain recorded for 2007 was $12.6 million ($7.6 million after-tax), and was included as a component of discontinued operations. In 2008, a $0.8 million impact of tax adjustments related to the 2007 PEP sale was recorded as income from discontinued operations.

Components of discontinued operations recorded in the Consolidated Statements of Income related to PEP were:

(Millions)	**February 22, 2007 through December 31, 2007**
Nonregulated revenue	$114.2
Operating and maintenance expense	28.5
Gain on PEP sale	(12.6)
Taxes other than income taxes	5.1
Other expense	0.1
Income before taxes	93.1
Provision for income taxes	34.6
Discontinued operations, net of tax	$ 58.5

It is Integrys Energy Group's policy to not allocate interest to discontinued operations unless the asset group being sold has external debt obligations. PEP had no external debt obligations during the period shown above.

Niagara

In January 2007, Integrys Energy Services completed the sale of Niagara for approximately $31 million. This facility was a merchant generation facility and sold power on a wholesale basis. The gain recorded in 2007 was $24.6 million pre-tax ($14.7 million after-tax) and was included as a component of discontinued operations.

During 2008, Integrys Energy Services recorded $0.1 million of income from discontinued operations related to amortization of an environmental indemnification guarantee included as part of the sale agreement.

Components of discontinued operations recorded in the Consolidated Statements of Income related to Niagara for the years ended December 31 were as follows:

(Millions)	**2007**	**2006**
Nonregulated revenue	$ 1.5	$19.3
Nonregulated cost of fuel, natural gas, and purchased power	1.0	12.9
Operating and maintenance expense	0.5	5.3
Gain on Niagara sale	(24.6)	–
Depreciation and amortization expense	–	0.4
Taxes other than income taxes	–	0.3
Other income	–	0.2
Income before taxes	24.6	0.6
Provision for income taxes	9.8	0.2
Discontinued operations, net of tax	$14.8	$ 0.4

No interest expense was allocated to discontinued operations as Niagara had no external debt obligations during the periods shown above.

Sunbury

In July 2006, Integrys Energy Services completed the sale of Sunbury. Sunbury's primary asset was the Sunbury generation plant located in Pennsylvania. This facility sold power on a wholesale basis when market conditions were economically favorable. The gain recorded in 2006 was $20.2 million pre-tax ($12.5 million after-tax), and was included as a component of discontinued operations.

Components of discontinued operations recorded in the Consolidated Statements of Income for the year ended December 31, 2006, related to Sunbury were as follows:

(Millions)	**2006**
Nonregulated revenue	$69.2
Nonregulated cost of fuel, natural gas, and purchased power	61.6
Operating and maintenance expense	17.9
Gain on Sunbury sale	(20.2)
Depreciation and amortization expense	0.3
Taxes other than income taxes	0.3
Income before taxes	9.3
Provision for income taxes	2.4
Discontinued operations, net of tax	$ 6.9

NOTE 4—PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment in service at December 31 consisted of the following utility, nonutility, and nonregulated assets:

(Millions)	2008	2007
Electric utility *	$2,777.5	$2,230.0
Natural gas utility	4,203.2	4,058.1
Total utility plant	6,980.7	6,288.1
Less: Accumulated depreciation	2,607.8	2,533.1
Net	4,372.9	3,755.0
Construction work in progress *	159.6	543.5
Net utility plant	4,532.5	4,298.5
Nonutility plant–utility segments	90.5	27.9
Less: Accumulated depreciation	52.2	8.8
Net	38.3	19.1
Construction work in progress	15.5	1.4
Net nonutility plant–utility segments	53.8	20.5
Electric nonregulated	195.2	168.0
Natural gas nonregulated	3.4	12.6
Other nonregulated	7.4	19.4
Total nonregulated property, plant, and equipment	206.0	200.0
Less: Accumulated depreciation	50.0	60.3
Net	156.0	139.7
Construction work in progress	31.0	5.1
Net nonregulated property, plant, and equipment	187.0	144.8
Total property, plant, and equipment	[illegible]	$4,463.8

** Includes the impact of the Weston 4 power plant becoming commercially operational in June 2008.*

NOTE 5—ACQUISITIONS AND DISPOSITIONS

Merger with PEC

The PEC merger was completed on February 21, 2007. The merger was accounted for under the purchase method of accounting, with Integrys Energy Group as the acquirer. In the merger, shareholders of PEC received 0.825 shares of Integrys Energy Group common stock, $1 par value, for each share of PEC common stock, no par value, which they held immediately prior to the merger. The total purchase price was approximately $1.6 billion. The results of operations attributable to PEC are included in the Consolidated Financial Statements for the year ended December 31, 2008, and for the period from February 22, 2007, through December 31, 2007.

The purchase price was allocated based on the estimated fair market value of the assets acquired and liabilities assumed. The excess of the purchase price over the estimated fair values of the tangible net assets acquired was allocated to identifiable intangible assets, with the remainder allocated to goodwill.

In order to achieve Integrys Energy Group's anticipated merger synergies, a restructuring plan was implemented, which included a process to eliminate duplicative positions within Integrys Energy Group. Costs associated with the merger-related involuntary termination of employees at PEC (the acquired company) were recognized as a liability assumed in the merger and included in the purchase price allocation in accordance with Emerging Issues Task Force Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." The following table summarizes the activity related to these specific costs for the years ended December 31:

(Millions)	[illegible]	2007
Accrued employee severance costs at beginning of period	[illegible]	$ –
Adjustments to purchase price	[illegible]	1.7
Other adjustments	[illegible]	–
Cash payments	[illegible]	(0.4)
Accrued employee severance costs at end of period	[illegible]	$1.3

Costs related to the involuntary termination of the acquirer's employees were expensed following the guidance of SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." Costs associated with the relocation or voluntary terminations of both Integrys Energy Group and PEC employees were expensed in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits." The following table summarizes the activity related to these specific costs for the years ended December 31:

(Millions)	[illegible]	2007
Accrued employee severance costs at beginning of period	[illegible]	$ –
Severance expense recorded	[illegible]	7.2
Cash payments	[illegible]	(2.4)
Accrued employee severance costs at end of period	[illegible]	$4.8

Purchase of Aquila, Inc.'s Michigan and Minnesota Natural Gas Distribution Operations

On April 1, 2006, Integrys Energy Group, through its wholly owned subsidiary MGU, completed the acquisition of natural gas distribution operations in Michigan from Aquila. On July 1, 2006, Integrys Energy Group, through its wholly owned subsidiary MERC, completed the acquisition of natural gas distribution operations in Minnesota from Aquila. Integrys Energy Group paid total consideration of $341.7 million for the Michigan natural gas distribution operations, and $315.7 million for the Minnesota natural gas distribution operations. Both amounts include closing adjustments related primarily to purchased working capital. Both transactions were accounted for under the purchase method of accounting.

Supplemental Pro Forma Information

The following table shows pro forma results of operations for Integrys Energy Group for the year ended December 31, 2007, as if the acquisition of PEC had been completed at January 1, 2007, as well as pro forma results of operations for Integrys Energy Group for the year ended December 31, 2006, as if the acquisitions of PEC and the Michigan and Minnesota natural gas distribution operations from Aquila had been completed at January 1, 2006. Pro forma results are presented for informational purposes only, assume commercial paper was used to finance the Michigan and Minnesota transactions, and are not necessarily indicative of what the actual results would have been had the acquisitions actually occurred on January 1, 2007, and January 1, 2006.

	Pro Forma for the Year Ended December 31	
(Millions, except per share amounts)	**2007**	**2006**
Total revenues	$10,997.7	$9,686.1
Income from continuing operations	$211.2	$144.8
Income available for common shareholders	$283.4	$178.4
Basic earnings per share – continuing operations	$2.73	$1.91
Basic earnings per share	$3.72	$2.40
Diluted earnings per share – continuing operations	$2.73	$1.91
Diluted earnings per share	$3.72	$2.40

The following dispositions occurred in 2006 but are reported as continuing operations.

Sale of WPS ESI Gas Storage, LLC

In April 2006, Integrys Energy Services sold WPS ESI Gas Storage, LLC, which owned a natural gas storage field located in the Kimball Township, St. Clair County, Michigan for $19.9 million. The transaction resulted in the recognition of a pre-tax gain of $9.0 million.

Sale of Guardian Pipeline

In April 2006, WPS Investments, LLC, a consolidated subsidiary of Integrys Energy Group, completed the sale of its one-third interest in Guardian Pipeline, LLC for $38.5 million. The transaction resulted in the recognition of a pre-tax gain of $6.2 million in the second quarter of 2006.

NOTE 6—JOINTLY OWNED UTILITY FACILITIES

WPS holds a joint ownership interest in certain electric generating facilities. WPS is entitled to receive generating capability and output of each facility equal to its respective ownership interest. WPS also pays its ownership share of additional construction costs, fuel inventory purchases, and operating expenses unless specific agreements have been executed to limit its maximum exposure to additional costs. WPS's share of significant jointly owned electric generating facilities as of December 31, 2008, was as follows:

(Millions, except for percentages and megawatts)	**Weston 4**	**West Marinette Unit No. 33**	**Columbia Energy Center Units 1 and 2**	**Edgewater Unit No. 4**
Ownership	**70.0%**	**68.0%**	**31.8%**	**31.8%**
WPS's share of rated capacity (megawatts)	**374.8**	**51.7**	**355.6**	**101.9**
Utility plant in service	**$611.9**	**$18.3**	**$159.5**	**$33.8**
Accumulated depreciation	**$ 40.4**	**$ 9.3**	**$ 99.5**	**$22.4**
In-service date	**2008**	**1993**	**1975 and 1978**	**1969**

WPS's share of direct expenses for these plants is recorded in operating expenses in the Consolidated Statements of Income. WPS has supplied its own financing for all jointly owned projects.

NOTE 7—REGULATORY ASSETS AND LIABILITIES

The following regulatory assets and liabilities were reflected in our Consolidated Balance Sheets as of December 31:

(Millions)	**2008**	2007
Regulatory assets		
Environmental remediation costs (net of insurance recoveries)	**$ 681.1**	$ 758.8
Pension and other postretirement benefit related items	**634.7**	221.9
Derivatives	**162.0**	34.4
De Pere Energy Center	**35.8**	38.2
Asset retirement obligations	**30.5**	17.0
Nuclear costs	**24.1**	34.7
Income tax related items	**23.2**	23.3
Energy recoveries	**23.1**	27.7
Weston 3 lightning strike	**22.3**	22.7
Unamortized loss on debt	**13.2**	13.8
Costs to achieve merger synergies	**12.1**	14.5
Rate case costs	**5.7**	–
Conservation Improvement Program costs	**4.8**	3.8
Midwest Independent Transmission System Operator, Inc. (MISO) costs	**–**	19.1
Other	**16.2**	14.1
Total	**$1,688.8**	$1,244.0
Balance Sheet Presentation		
Current	**$ 244.0**	$ 141.7
Long-term	**1,444.8**	1,102.3
Total	**$1,688.8**	$1,244.0
Regulatory liabilities		
Cost of removal reserve	**$ 231.6**	$ 217.4
Energy refunds	**34.1**	55.7
Pension and other postretirement benefit related items	**26.1**	59.1
American Transmission Company (ATC) and MISO refunds	**9.6**	5.3
Decoupling	**9.4**	–
Income tax related items	**8.2**	10.8
Derivatives	**4.9**	13.9
Enhanced Efficiency Program	**4.8**	–
Other	**5.6**	8.1
Total	**$ 334.3**	$ 370.3
Balance Sheet Presentation		
Current	**$ 58.8**	$ 77.9
Long-term	**275.5**	292.4
Total	**$ 334.3**	$ 370.3

Our utility subsidiaries expect to recover their regulatory assets and incur future costs or refund their regulatory liabilities through rates charged to customers based on specific ratemaking decisions or precedent for each item over periods specified by the regulators or over the normal operating period of the assets and liabilities to which they relate. Based on prior and current rate treatment for such costs, we believe it is probable that our utility subsidiaries will continue to recover from customers the regulatory assets described above.

The regulatory assets listed in the table above related to WPS's environmental remediation costs, the Weston 3 lightning strike, rate case costs, and debt and PGL and NSG, are not earning a rate of return. The regulatory asset for WPS's environmental remediation costs was $74.1 million at December 31, 2008, and includes both liabilities and costs incurred to remediate the former manufactured gas plant sites that have not yet been recovered through rates. At December 31, 2008, environmental remediation costs that have been incurred but not yet recovered in rates were not significant. WPS is authorized recovery of the regulatory asset related to the Weston 3 lightning strike over a six-year period. The regulatory assets related to debt at PGL and NSG are not included in rate base, but are recovered over the term of the debt through the rate of return authorized by the Illinois Commerce Commission (ICC). The regulatory assets related to rate case costs are authorized recovery over a five-year period. WPS's regulatory assets are expected to be recovered from customers in future rates; however, the carrying costs of these assets are borne by Integrys Energy Group's shareholders.

See Note 1(g), *"Summary of Significant Accounting Policies – Risk Management Activities,"* Note 13, *"Asset Retirement Obligations,"* Note 14, *"Income Taxes,"* Note 15, *"Commitments and Contingencies,"* Note 17, *"Employee Benefit Plans,"* and Note 23, *"Regulatory Environment,"* for more information on some of the more significant regulatory assets and liabilities listed in the above table.

NOTE 8—INVESTMENTS IN AFFILIATES, AT EQUITY METHOD

Investments in corporate joint ventures and other companies accounted for under the equity method at December 31, 2008, and 2007 were as follows:

(Millions)	[redacted]	2007
ATC	[redacted]	$296.6
Wisconsin River Power Company (WRPC)	[redacted]	9.8
Other	[redacted]	1.3
Investments in affiliates, at equity method	[redacted]	$307.7

Investments in affiliates accounted for under the equity method are included in other assets on the Consolidated Balance Sheets, and the equity income (loss) is recorded in miscellaneous income on the Consolidated Statements of Income. Integrys Energy Group is taxed on ATC's equity income, rather than ATC, due to the tax flow-through nature of ATC's business structure. Accordingly, Integrys Energy Group's provision for income taxes includes taxes on ATC's equity income. Included in other investments in the above table is Integrys Energy Services' ownership in ECO Coal Pelletization #12, LLC. See below for further explanation of this investment.

ATC

Integrys Energy Group had an approximate 34% ownership interest in ATC at December 31, 2008. ATC is a for-profit, transmission-only company. ATC owns, maintains, monitors, and operates electric transmission assets in portions of Wisconsin, Michigan, Minnesota, and Illinois.

The regulated electric utilities provide construction and other services to, and receive network transmission services from, ATC. The related party transactions recorded by the regulated electric utilities, capital contributions to ATC, and dividends received from ATC in the years ended December 31 were as follows:

(Millions)	[redacted]	2007	2006
Total charges to ATC for services and construction	[redacted]	$98.6	$126.5
Total costs for network transmission service provided by ATC	[redacted]	78.1	63.3
Net amounts received from (advanced to) ATC for transmission interconnection	[redacted]	(23.9)	(11.6)
Capital contributions to ATC	[redacted]	50.9	36.5
Dividends received from ATC	[redacted]	36.7	29.7

There were no advances to ATC for transmission interconnections recorded at December 31, 2008. The amount related to these advances classified within accounts receivable and accrued unbilled revenues was $82.3 million at December 31, 2007.

Of Integrys Energy Group's equity in net income disclosed below, $66.1 million, $50.5 million, and $39.0 million is the pre-tax income related to its investment in ATC in 2008, 2007, and 2006, respectively.

WRPC

WPS owns 50% of the voting stock of WRPC, which operates two hydroelectric plants and an oil-fired combustion turbine. Two-thirds of the energy output of the hydroelectric plants is sold to WPS, and the remaining one-third is sold to Wisconsin Power and Light. The electric power from the combustion turbine is sold in equal parts to WPS and Wisconsin Power and Light.

WPS has sales to and purchases from WRPC and receives net proceeds from sales of energy into the MISO market from WRPC. The related party transactions recorded and net proceeds and dividends received in the years ended December 31 were as follows:

(Millions)	[redacted]	2007	2006
Revenues from services provided to WRPC	[redacted]	$1.0	$1.5
Purchases of energy from WRPC	[redacted]	4.7	4.1
Net proceeds from WRPC sales of energy to MISO	[redacted]	6.0	4.2
Dividends received from WRPC	[redacted]	0.9	4.2

Of Integrys Energy Group's equity in net income disclosed below, $2.2 million, $1.8 million, and $3.2 million is the pre-tax income related to WPS's investment in WRPC in 2008, 2007, and 2006, respectively.

ECO Coal Pelletization #12

At December 31, 2008, Integrys Energy Services held a 70% ownership interest in ECO Coal Pelletization #12, LLC, which held an equity method investment in an entity that produced synthetic fuel for tax credits under Section 29/45K of the Internal Revenue Code. Integrys Energy Services' investment in this facility was not significant at December 31, 2008, 2007, or 2006. By law, Section 29/45K federal tax credits for synthetic fuel produced from coal expired on December 31, 2007; therefore, this facility ceased operation effective January 1, 2008. Consequently, the losses and royalty income received from this investment were not significant during 2008. The losses and royalty income received from the equity method investment Integrys Energy Services held through its ownership interest in ECO Coal Pelletization #12, LLC during 2007 and 2006, were as follows:

(Millions)	2007	2006
Losses generated from operations of ECO Coal Pelletization #12	$(18.2)	$(23.9)
Integrys Energy Services' partners' share of the losses (recorded as minority interest)	0.1	3.8
Royalty income recognized	1.7	–

In 2007 and 2006, the operation of this facility generated positive earnings when including the tax credits generated and the impact of gains on oil options utilized to mitigate the risk that rising oil prices had on the value of the tax credits.

Guardian Pipeline

In April 2006, Integrys Energy Group completed the sale of its one-third interest in Guardian Pipeline. At the time of sale, Guardian Pipeline, LLC owned a natural gas pipeline, which began operating in 2002, that stretched about 140 miles from near Joliet, Illinois, into southern Wisconsin. It could transport up to 750 million cubic feet of natural gas daily. See Note 5, "*Acquisitions and Dispositions,*" for more information related to the sale.

Integrys Energy Services recorded related party transactions for purchases from Guardian Pipeline. These purchases amounted to $0.9 million in 2006 through the date of sale.

Financial Data

Combined financial data of Integrys Energy Group's significant equity method investments, ATC and WRPC, are included in the table below. The financial data of Guardian Pipeline is not included, as Integrys Energy Group sold this investment in April 2006 and the financial information from January 1, 2006, through the date of sale was not significant.

(Millions)	**2008**	2007	2006
Income statement data			
Revenues	**$ 474.0**	$ 415.6	$ 347.5
Operating expenses	**214.6**	203.9	184.3
Other expense	**67.1**	54.2	34.9
Net income	**$ 192.3**	$ 157.5	$ 128.3
Integrys Energy Group's equity in net income	**$ 68.3**	$ 52.3	$ 42.2
Balance sheet data			
Current assets	**$ 52.5**	$ 52.3	$ 36.2
Noncurrent assets	**2,494.8**	2,207.8	1,872.4
Total assets	**$2,547.3**	$2,260.1	$1,908.6
Current liabilities	**$ 252.4**	$ 317.7	$ 306.4
Long-term debt	**1,109.4**	899.1	648.9
Other noncurrent liabilities	**119.3**	111.1	128.2
Shareholders' equity	**1,066.2**	932.2	825.1
Total liabilities and shareholders' equity	[illegible]	$2,260.1	$1,908.6

NOTE 9—GOODWILL AND OTHER INTANGIBLE ASSETS

Integrys Energy Group had the following changes to the carrying amount of goodwill for the year ended December 31, 2008:

(Millions)	**Natural Gas Utility Segment**	**Integrys Energy Services**	**Total**
Goodwill recorded at December 31, 2007	$936.8	$11.5	$948.3
Adjustments to PEC purchase price allocation related to income taxes	**(3.3)**	**(4.6)**	**(7.9)**
Impairment loss *	**(6.5)**	**–**	**(6.5)**
Goodwill recorded at December 31, 2008	[illegible]	[illegible]	[illegible]

* *A goodwill impairment loss in the amount of $6.5 million, after-tax, was recognized for NSG in the second quarter of 2008. On at least an annual basis, Integrys Energy Group is required by GAAP to test goodwill for impairment at each of its reporting units. Reporting units at Integrys Energy Group that have a goodwill balance and are subject to these impairment tests include PGL, NSG, MGU, MERC, WPS's natural gas utility, and Integrys Energy Services. PGL, NSG, MGU, and MERC were recorded at their approximate fair market values at the date of acquisition. Since the acquisitions of PGL, NSG, MGU, and MERC all occurred within the last few years, even a slight decline in fair value can result in a potential impairment loss. In order to identify a potential impairment, the estimated fair value of a reporting unit is compared with its carrying amount, including goodwill. A present value technique was utilized to estimate the fair value of NSG at April 1, 2008. The goodwill impairment recognized for NSG was due to a decline in the estimated fair value of NSG, caused primarily by a decrease in forecasted results as compared to the forecast at the time of the acquisition. Worsening economic factors also contributed to the decline in fair value.*

Identifiable intangible assets other than goodwill are included as a component of other assets within the Consolidated Balance Sheets as listed below.

(Millions)	December 31, 2008 Gross Carrying Amount	December 31, 2008 Accumulated Amortization	December 31, 2008 Net	December 31, 2007 Gross Carrying Amount	December 31, 2007 Accumulated Amortization	December 31, 2007 Net
Amortized intangible assets (liabilities)						
Customer-related [1]	[illegible]	$(14.2)	$18.4	$32.6	$ (9.3)	$23.3
Natural gas and electric contract assets [2,3]	[illegible]	(34.6)	5.5	60.1	(34.1)	26.0
Natural gas and electric contract liabilities [2,4]	[illegible]	20.2	(13.4)	(33.6)	13.1	(20.5)
Emission allowances [5]	2.3	(0.1)	2.2	2.4	(0.2)	2.2
Renewable energy credits [6]	3.4	(2.1)	1.3	0.4	(0.4)	–
Other	3.0	(1.0)	2.0	3.4	(0.8)	2.6
Total	[illegible]	[illegible]	$16.0	$65.3	$(31.7)	$33.6
Unamortized intangible assets						
Trade name [7]	5.2	–	5.2	5.2	–	5.2
Total intangible assets	[illegible]	[illegible]	[illegible]	$70.5	$(31.7)	$38.8

[1] *Includes customer relationship assets associated with both PEC's former nonregulated retail natural gas and electric operations and MERC's nonutility home services business. The remaining weighted-average amortization period at December 31, 2008, for customer-related intangible assets is approximately 7 years.*

[2] *Represents the fair value of certain PEC natural gas and electric customer contracts acquired in the merger that were not considered to be derivative instruments, and as a result, were recorded as intangible assets.*

[3] *Includes both short-term and long-term intangible assets related to customer contracts in the amount of $3.1 million and $2.4 million, respectively, at December 31, 2008, and $20.5 million and $5.5 million, respectively, at December 31, 2007. The weighted-average amortization period at December 31, 2008, for these intangible assets is 2.2 years.*

[4] *Includes both short-term and long-term intangible liabilities related to customer contracts in the amount of $6.0 million and $7.4 million, respectively, at December 31, 2008, and $7.1 million and $13.4 million, respectively at December 31, 2007. The weighted-average amortization period at December 31, 2008, for these intangible liabilities is 2.0 years.*

[5] *Emission allowances do not have a contractual term or expiration date.*

[6] *Used at Integrys Energy Services to comply with state Renewable Portfolio Standards, as well as for trading purposes.*

[7] *Represents the fair value of the MGU trade name acquired from Aquila.*

Intangible asset amortization expense, excluding amortization related to natural gas and electric contracts, was recorded as a component of depreciation and amortization expense. Amortization for the years ended December 31, 2008, 2007, and 2006, was $7.9 million, $8.5 million, and $2.1 million, respectively.

Amortization expense for the next five fiscal years is estimated to be:

(Millions)	
For year ending December 31, 2009	$2.3
For year ending December 31, 2010	2.7
For year ending December 31, 2011	2.1
For year ending December 31, 2012	2.1
For year ending December 31, 2013	[illegible]

Amortization of the natural gas and electric contract intangible assets was recorded as a component of nonregulated cost of fuel, natural gas, and purchased power. Amortization of these contracts for the years ended December 31, 2008, and 2007, resulted in an increase to nonregulated fuel, natural gas, and purchased power in the amount of $34.4 million and $21.0 million, respectively.

Amortization of these contracts for the next five fiscal years is estimated to be:

(Millions)	
For year ending December 31, 2009	$(2.9) *
For year ending December 31, 2010	(2.7) *
For year ending December 31, 2011	(2.0) *
For year ending December 31, 2012	(0.3) *
For year ending December 31, 2013	0.1

* *Amortization of these contracts is anticipated to decrease nonregulated cost of fuel, natural gas, and purchased power because the fair value of the portion of the contracts that relates to these periods was negative (or "out-of-the-money") at the date the respective businesses were acquired.*

NOTE 10—LEASES

Integrys Energy Group leases various property, plant, and equipment. Terms of the operating leases vary, but generally require Integrys Energy Group to pay property taxes, insurance premiums, and maintenance costs associated with the leased property. Many of Integrys Energy Group's leases contain one of the following options upon the end of the lease term: (a) purchase the property at the current fair market value or (b) exercise a renewal option, as set forth in the lease agreement. Rental expense attributable to operating leases was $17.0 million, $13.6 million, and $7.0 million in 2008, 2007, and 2006, respectively. Future minimum rental obligations under non-cancelable operating leases are payable as follows:

Year Ending December 31 (Millions)	
2009	$11.1
2010	9.8
2011	6.7
2012	7.2
2013	6.0
Later years	4.6
Total payments	[illegible]

NOTE 11—SHORT-TERM DEBT AND LINES OF CREDIT

Integrys Energy Group's short-term borrowings consist of sales of commercial paper, borrowings under revolving credit facilities, and short-term notes. Amounts shown are as of December 31:

(Millions, except percentages)	2008	2007	2006
Commercial paper outstanding	[illegible]	$308.2	$562.8
Average discount rate on outstanding commercial paper	[illegible]	5.51%	5.43%
Short-term notes payable outstanding	[illegible]	$10.0	$10.0
Average interest rate on short-term notes payable	[illegible]	5.20%	5.30%
Borrowings under revolving credit facilities	[illegible]	$150.0	$150.0
Average interest rate on revolving credit facilities	[illegible]	3.56%	5.58%

The commercial paper at December 31, 2008, had varying maturity dates ranging from January 2, 2009, through January 30, 2009.

Integrys Energy Group manages its liquidity by maintaining adequate external financing commitments. The information in the table below relates to Integrys Energy Group's short-term debt, lines of credit, and remaining available capacity as of December 31:

(Millions)	Maturity	2008	2007
Revolving credit facility (Integrys Energy Group) (1)	06/02/10	$ 500.0	$ 500.0
Revolving credit facility (Integrys Energy Group) (1)	06/09/11	500.0	500.0
Revolving credit facility (Integrys Energy Group) (1)(9)	05/03/09	250.0	–
Revolving credit facility (WPS) (2)	06/02/10	115.0	115.0
Revolving credit facility (PEC) (1)(4)	06/13/11	400.0	400.0
Revolving credit facility (PGL) (3)	07/12/10	250.0	250.0
Revolving credit facility (Integrys Energy Services) (4)(5)	04/08/09	175.0	150.0
Revolving short-term notes payable (WPS) (6)	05/13/09	10.0	10.0
Short-term notes payable (Integrys Energy Group) (8)	03/30/09	171.1	–
Uncommitted secured cross-exchange agreement (Integrys Energy Services) (7)		–	25.0
Total short-term credit capacity		2,371.1	1,950.0
Less:			
Uncollateralized portion of gross margin credit agreement		–	10.8
Letters of credit issued inside credit facilities		414.6	138.9
Loans outstanding under credit agreements and notes payable		656.1	160.0
Commercial paper outstanding		532.9	308.2
Accrued interest or original discount on outstanding commercial paper		0.8	0.5
Available capacity under existing agreements		[illegible]	$1,331.6

(1) *Provides support for Integrys Energy Group's commercial paper borrowing program.*
(2) *Provides support for WPS's commercial paper borrowing program.*
(3) *Provides support for PGL's commercial paper borrowing program.*
(4) *Borrowings under these agreements are guaranteed by Integrys Energy Group.*
(5) *This facility matured in April 2008, at which time the available borrowing capacity under the facility was increased to $175.0 million and the maturity date was extended to April 8, 2009.*
(6) *This note is renewed every six months.*
(7) *This facility matured in April 2008, at which time the facility was renewed and the maturity date was extended. However, in October 2008, borrowings under this facility were paid in full as the facility was terminated. Borrowings under this facility are no longer available.*
(8) *In November 2008, Integrys Energy Group entered into a short-term debt agreement extending through March 2009 to finance its working capital requirements and for general corporate purposes. The agreement requires principal and interest payments to be made in yen. Integrys Energy Services entered into two forward foreign currency exchange contracts to hedge the variability of the foreign currency exchange rate risk associated with the principal and fixed rate interest payments, and Integrys Energy Group expects the principal amount of repayment at maturity, combined with the settlement amount of the forward contracts, to be $156.7 million. See Note 2, "Risk Management Activities" for more information.*
(9) *In November 2008, Integrys Energy Group entered into a revolving credit agreement to finance its working capital requirements and for general corporate purposes which extends to May 2009.*

At December 31, 2008, Integrys Energy Group and its subsidiaries were in compliance with all covenants relating to outstanding short-term debt and expect to be in compliance with all such debt covenants for the foreseeable future. Integrys Energy Group and certain subsidiaries' revolving credit agreements contain financial and other covenants, including, but not limited to a requirement to maintain a debt to total capitalization ratio not to exceed 65%, excluding non-recourse debt. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. Termination of the agreements could permit lenders to require immediate repayment of the outstanding borrowings thereunder.

NOTE 12—LONG-TERM DEBT

(Millions)				December 31 2008	2007
WPS First Mortgage Bonds [1]					
	Series	Year Due			
	7.125%	2023		$ 0.1	$ 0.1
WPS Senior Notes [1][2]					
	Series	Year Due			
	6.125%	2011		150.0	150.0
	4.875%	2012		150.0	150.0
	4.80%	2013		125.0	125.0
	3.95%	2013		22.0	22.0
	6.375%	2015		125.0	–
	5.65%	2017		125.0	125.0
	6.08%	2028		50.0	50.0
	5.55%	2036		125.0	125.0
UPPCO First Mortgage Bonds [3]					
	Series	Year Due			
	9.32%	2021		11.7	12.6
PEC Unsecured Senior Note [4]					
	Series	Year Due			
	A, 6.90%	2011		325.0	325.0
Fair value hedge adjustment				3.2	0.3
PGL Fixed First and Refunding Mortgage Bonds [5]					
	Series	Year Due			
	HH, 4.75%	2030	Adjustable after July 1, 2014	50.0	50.0
	KK, 5.00%	2033		50.0	50.0
	LL, 3.75%	2033	Adjustable after February 1, 2012	50.0	50.0
	MM-2, 4.00%	2010		50.0	50.0
	NN-2, 4.625%	2013		75.0	75.0
	QQ, 4.875%	2038	Adjustable after November 1, 2018	75.0	75.0
	RR, 4.30%	2035	Adjustable after June 1, 2016	50.0	50.0
	SS, 7.00%	2013		45.0	–
	TT, 8.00%	2018		5.0	–
PGL Adjustable First and Refunding Mortgage Bonds [6]					
	Series	Year Due			
	OO	2037		51.0	51.0
	PP	2037		–	51.0
NSG First Mortgage Bonds [7]					
	Series	Year Due			
	M, 5.00%	2028		28.6	29.1
	N-2, 4.625%	2013		40.0	40.0
	O, 7.00%	2013		6.5	–
Integrys Energy Group Unsecured Senior Notes					
	Series	Year Due			
	5.375%	2012		100.0	100.0
	7.00%	2009		150.0	150.0
Integrys Energy Group Unsecured Junior Subordinated Notes [8]					
	Series	Year Due			
	6.11%	2066		300.0	300.0
Unsecured term loan due 2010 – Integrys Energy Group				65.6	65.6
Term loans – nonrecourse, collateralized by nonregulated assets [9]				6.6	10.5
Integrys Energy Services' loan				–	0.1
Other term loan [10]				27.0	27.0
Senior secured note [11]				–	1.7
Total				2,457.5	2,311.0
Unamortized discount and premium on bonds and debt				5.7	9.3
Total debt				2,463.2	2,320.3
Less current portion				(155.2)	(55.2)
Total long-term debt				$2,308.0	$2,265.1

(1) *WPS's First Mortgage Bonds and Senior Notes are subject to the terms and conditions of WPS's First Mortgage Indenture. Under the terms of the Indenture, substantially all property owned by WPS is pledged as collateral for these outstanding debt securities. All of these debt securities require semi-annual payments of interest. WPS Senior Notes become non-collateralized if WPS retires all of its outstanding First Mortgage Bonds and no new mortgage indenture is put in place.*

(2) *In December 2008, WPS issued $125.0 million of Series 6.375% Senior Notes due December 1, 2015. The net proceeds from the issuance of the Senior Notes were used for funding construction costs and other capital additions, retiring short-term debt related to construction, and general corporate utility purposes.*

In November 2007, WPS issued $125.0 million of Series 5.65% Senior Notes due November 1, 2017. The net proceeds from the issuance of the Senior Notes were used for funding construction costs and other capital additions and general corporate utility purposes.

(3) *Under the terms of UPPCO's First Mortgage Indenture, substantially all property owned by UPPCO is pledged as collateral for this outstanding debt series. Interest payments are due semi-annually with a sinking fund payment of $900,000 due each November 1. The final sinking fund payment due November 1, 2021, will completely retire the series.*

(4) *On March 6, 2007, Integrys Energy Group announced that it had entered into a First Supplemental Indenture with PEC and The Bank of New York Trust Company, N.A. The terms of the supplemental indenture provide that Integrys Energy Group will fully and unconditionally guarantee, on a senior unsecured basis, PEC's obligations under its $325.0 million, 6.9% notes due January 15, 2011. See Note 16, "Guarantees," for more information related to this guaranty.*

(5) *In November 2008, PGL issued $45 million of Series SS, 7.0%, 5-year First and Refunding Mortgage Bonds due November 1, 2013 and $5 million of Series TT, 8.0%, 10-year First and Refunding Mortgage Bonds due November 1, 2018. The net proceeds from the issuance of these bonds were used to reduce short-term debt and for other general corporate utility purposes. The first and refunding mortgage bonds were sold in a private placement and are not registered under the Securities Act of 1933.*

On February 1, 2008, the interest rate on the $50.0 million 3.05% Series LL First Mortgage Bonds at PGL, which support the Illinois Development Finance Authority Adjustable-Rate Gas Supply Refunding Revenue Bonds, Series 2003B, was established at a term rate of 3.75% through January 31, 2012, adjustable after February 1, 2012. These bonds were subject to a mandatory tender for purchase and were remarketed on February 1, 2008. As a result, these bonds were presented in the current portion of long-term debt on Integrys Energy Group's Consolidated Balance Sheet at December 31, 2007. These bonds were included as long-term debt in the December 31, 2008, Consolidated Balance Sheet.

PGL's First Mortgage Bonds are subject to the terms and conditions of PGL's First Mortgage Indenture dated January 2, 1926, as supplemented. Under the terms of the Indenture, substantially all property owned by PGL is pledged as collateral for these outstanding debt securities.

(6) *PGL has outstanding $51.0 million of Adjustable Rate, Series OO Bonds, due October 1, 2037, which are currently in a 35-day Auction Rate mode (the interest rate is reset every 35 days through an auction process). The weighted-average interest rate for 2008 was 5.391% for these bonds.*

On April 17, 2008, PGL completed the purchase of $51.0 million of Illinois Development Finance Authority Series 2003D Bonds, due October 1, 2037, and backed by PGL Series PP Bonds. Upon repurchase, the auction rate mode was converted from a 35-day mode to a weekly variable rate mode. This transaction was treated as a repurchase of the Series PP Bonds by PGL. As a result, the liability related to the Series PP Bonds was extinguished. PGL intends to hold the bonds while it continues to monitor the tax-exempt market and assess potential remarketing or refinancing opportunities.

PGL's First Mortgage Bonds are subject to the terms and conditions of PGL's First Mortgage Indenture dated January 2, 1926, as supplemented. Under the terms of the Indenture, substantially all property owned by PGL is pledged as collateral for these outstanding debt securities.

PGL has utilized certain First Mortgage Bonds to secure tax exempt interest rates. The Illinois Finance Authority and the City of Chicago have issued Tax Exempt Bonds, and the proceeds from the sale of these bonds were loaned to PGL. In return, PGL issued equal principal amounts of certain collateralized First Mortgage Bonds

(7) *In November 2008, NSG issued $6.5 million of Series O, 7.0%, 5-year First Mortgage Bonds due November 1, 2013. The net proceeds from the issuance of the First Mortgage Bonds was used for general corporate utility purposes. The First Mortgage Bonds were sold in a private placement and are not registered under the Securities Act of 1933.*

NSG's First Mortgage Bonds are subject to the terms and conditions of NSG's First Mortgage Indenture dated April 1, 1955, as supplemented. Under the terms of the Indenture, substantially all property owned by NSG is pledged as collateral for these outstanding debt securities.

NSG has utilized First Mortgage Bonds to secure tax exempt interest rates The Illinois Finance Authority has issued Tax Exempt Bonds, and the proceeds from the sale of these bonds were loaned to NSG. In return, NSG issued equal principal amounts of certain collateralized First Mortgage Bonds.

(8) *On December 1, 2006, Integrys Energy Group issued $300.0 million of Junior Subordinated Notes. Due to certain features of these notes, rating agencies consider them to be hybrid instruments with a combination of debt and equity characteristics. These notes have a 60-year term and rank junior to all current and future indebtedness of Integrys Energy Group, with the exception of trade accounts payable and other accrued liabilities arising in the ordinary course of business. Interest is payable semi-annually at the stated rate of 6.11% for the first ten years, but the rate has been fixed at 6.22% for this period through the use of forward-starting interest rate swaps. The interest rate will float for the remainder of the term. The notes can be prepaid without penalty after the first ten years. Integrys Energy Group has agreed, however, in a replacement capital covenant with the holders of Integrys Energy Group's 5.375% Unsecured Senior Notes due December 1, 2012, that it will not redeem or repurchase the Junior Subordinated Notes on or prior to December 1, 2036, unless such repurchases or redemptions are made from the proceeds of the sale of specific securities considered by rating agencies to have equity characteristics equal to or greater than those of the Junior Subordinated Notes.*

(9) *Borrowings by Integrys Energy Services under term loans and collateralized by nonregulated assets totaled $6.6 million at December 31, 2008. The assets of WPS New England Generation, Inc. and WPS Canada Generation, Inc., subsidiaries of Integrys Energy Services, collateralize $1.9 million and $4.7 million, respectively, of the total outstanding amount. Both loans have semi-annual installment payments, interest rates of 8.75%, maturity dates in May 2010, and are guaranteed by Integrys Energy Group starting January 2009.*

(10) *In April 2001, the Schuylkill County Industrial Development Authority issued $27.0 million of Refunding Tax Exempt Bonds. The proceeds from the bonds were loaned to WPS Westwood Generation, LLC, a subsidiary of Integrys Energy Services. This loan is repaid by WPS Westwood Generation to Schuylkill County Industrial Development Authority with monthly interest only payments and has a floating interest rate that is reset weekly. At December 31, 2008, the interest rate was 1.38%. The loan is to be repaid by April 2021. Integrys Energy Group agreed to guarantee WPS Westwood Generation's obligation to provide sufficient funds to pay the loan and the related obligations and indemnities.*

(11) *On June 26, 2008, Upper Peninsula Building Development Corporation, a subsidiary of Integrys Energy Group, repaid the outstanding principal balance on its 9.25% Senior Secured Note. The note was secured by a First Mortgage lien on a building sold in July 2008 that was previously owned and leased to UPPCO for use as their corporate headquarters.*

At December 31, 2008, Integrys Energy Group and each of its subsidiaries were in compliance with all respective covenants relating to outstanding long-term debt and expect to be in compliance with all such debt covenants for the foreseeable future. Integrys Energy Group and certain subsidiaries' long-term debt obligations contain covenants related to payment of principal and interest when due and various financial reporting obligations. Failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of outstanding debt obligations.

A schedule of all principal debt payment amounts, including bond maturities and early retirements, for Integrys Energy Group is as follows:

Year Ending December 31 *(Millions)*	
2009	[illegible]
2010	[illegible]
2011	[illegible]
2012	[illegible]
2013	[illegible]
Later years	[illegible]
Total payments	[illegible]

NOTE 13—ASSET RETIREMENT OBLIGATIONS

The utility segments have asset retirement obligations primarily related to removal of natural gas distribution pipe (including asbestos and PCBs); asbestos abatement at certain facilities, office buildings, and service centers; disposal of PCB-contaminated transformers; and closure of fly-ash landfills at certain generation facilities. In accordance with SFAS No. 71, the utilities establish regulatory assets and liabilities to record the differences between ongoing expense recognition under SFAS No. 143 and FASB Interpretation No. 47, and the ratemaking practices for retirement costs authorized by the applicable regulators.

Asset retirement obligations at Integrys Energy Services relate to asbestos abatement at certain generation facilities.

As discussed in Note 3, *"Discontinued Operations,"* Integrys Energy Services completed the sale of Sunbury in July 2006, which included the transfer of asset retirement obligations related to Sunbury.

Changes to Asset Retirement Obligation Liabilities

The following table shows changes to Integrys Energy Group's asset retirement obligations through December 31, 2008.

(Millions)	Utilities	Integrys Energy Services	Total
Asset retirement obligations at December 31, 2005	$ 8.6	$ 6.3	$ 14.9
Accretion	0.5	0.2	0.7
Asset retirement obligations from acquisition of natural gas operations in Michigan and Minnesota	0.3	–	0.3
Asset retirement obligations transferred in sales	–	(5.8)	(5.8)
Asset retirement obligations at December 31, 2006	9.4	0.7	10.1
Accretion	6.8	–	6.8
Asset retirement obligations from merger with PEC	124.9	–	124.9
Asset retirement obligations transferred in sales	(0.2)	–	(0.2)
Settlements	(1.4)	–	(1.4)
Asset retirement obligations at December 31, 2007	139.5	0.7	140.2
Accretion	**7.8**	**–**	**7.8**
Additions and revisions to estimated cash flows	**31.7**	**–**	**31.7**
Asset retirement obligations transferred in sales	**(0.1)**	**(0.5)**	**(0.6)**
Asset retirement obligations at December 31, 2008	[illegible]	**$0.2**	[illegible]

NOTE 14—INCOME TAXES

Deferred Tax Assets and Liabilities

Certain temporary book to tax differences, for which the offsetting amount is recorded as a regulatory asset or liability, are presented in the table below as net amounts, consistent with regulatory treatment.

The principal components of our deferred tax assets and liabilities recognized in the Consolidated Balance Sheets as of December 31 are as follows:

(Millions)	**2008**	2007
Deferred tax assets:		
Tax credit carryforwards	**$ 96.0**	$112.0
Employee benefits	**88.9**	60.8
State capital and operating loss carryforwards	**45.9**	14.5
Other	**52.2**	41.9
Total deferred tax assets	**283.0**	229.2
Valuation allowance	**(2.3)**	(2.3)
Net deferred tax assets	**$280.7**	$226.9
Deferred tax liabilities:		
Plant related	**$642.1**	$568.8
Regulatory deferrals	**70.3**	73.2
Price risk management	**45.6**	93.2
Total deferred tax liabilities	**$758.0**	$735.2
Consolidated balance sheet presentation:		
Current deferred tax liabilities	**$ 71.6**	$ 13.9
Long-term deferred tax liabilities	**405.7**	494.4
Net deferred tax liabilities	[illegible]	$508.3

Deferred tax credit carryforwards at December 31, 2008, include $85.2 million of alternative minimum tax credits related to tax credits available under former Section 29/45K of the Internal Revenue Code. These alternative minimum tax credits can be carried forward indefinitely. Carryforward periods for state capital and operating losses vary. In the majority of states in which Integrys Energy Group operates the period is 15 years or more, with the majority beginning to expire in 2013. Valuation allowances have been established for certain state operating and capital loss carryforwards due to the uncertainty of the ability to realize the benefit of these losses in the future.

Federal Income Tax Expense

The following table presents a reconciliation of federal income taxes to the provision for income taxes reported in the Consolidated Statements of Income for the periods ended December 31. The taxes are calculated by multiplying the statutory federal income tax rate by book income before federal income tax.

(Millions, except for percentages)	2008		2007		2006	
	Rate	Amount	Rate	Amount	Rate	Amount
Statutory federal income tax	35.0%	$61.6	35.0%	$93.4	35.0%	$68.8
State income taxes, net	6.8	12.0	4.3	11.5	6.5	12.8
Unrecognized tax benefits	0.1	0.2	0.4	1.0	–	–
Benefits and compensation	[illegible]	(4.8)	(2.5)	(6.8)	(2.5)	(4.8)
Investment tax credit	(1.0)	(1.8)	(0.6)	(1.5)	(0.4)	(0.8)
Federal tax credits	(6.0)	(10.6)	(5.4)	(14.3)	(15.8)	(30.2)
Other differences, net	[illegible]	(5.4)	1.0	2.7	0.1	(0.8)
Effective income tax	[illegible]	[illegible]	32.2%	$86.0	22.9%	$45.0
Current provision						
Federal		$(10.5)		$ (6.8)		$21.1
State		(3.1)		8.9		6.2
Foreign		1.9		4.7		5.3
Total current provision		$(11.7)		$6.8		$32.6
Deferred provision		[illegible]		$78.2		$11.4
Net operating loss carryforwards		–		(0.9)		1.8
Unrecognized tax benefits		[illegible]		1.0		–
Interest		(0.1)		2.4		–
Penalties		0.4		(0.1)		–
Investment tax credit—amortization		(1.8)		(1.4)		(0.8)
Total income tax expense		[illegible]		$86.0		$45.0

Foreign income before taxes was $12.0 million in 2008, $23.3 million in 2007, and $24.5 million in 2006.

As the related temporary differences reverse, our regulated utilities are prospectively refunding taxes to or collecting taxes from customers for which deferred taxes were recorded in prior years at rates different than current rates. The net regulatory asset for these and other regulatory tax effects totaled $13.9 million and $11.3 million as of December 31, 2008, and 2007, respectively.

Effective January 1, 2007, Integrys Energy Group records penalties and accrued interest related to income taxes as a component of income tax expense. Prior to January 1, 2007, Integrys Energy Group recorded interest and penalties as components of income before taxes. Integrys Energy Group recognized interest and penalties of $0.3 million in 2008, $2.3 million in 2007, and $0.3 million in 2006. Integrys Energy Group had accrued interest and penalties related to uncertain tax positions of $6.0 million at December 31, 2008, $4.6 million at December 31, 2007, and $0.2 million at January 1, 2007.

Unrecognized Tax Benefits

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

(Millions)	2008	2007
Balance at January 1	$10.0	$ 3.7
Increase related to tax positions acquired	–	13.9
Increase related to tax positions taken in prior years	23.8	0.5
Decrease related to tax positions taken in prior years	(7.7)	(0.3)
Decrease related to tax positions taken in current year	–	(3.9)
Decrease related to settlements	(3.7)	(3.6)
Decrease related to lapse of statutes	–	(0.3)
Balance at December 31	$22.4	$10.0

In 2008, unrecognized tax benefits at Integrys Energy Group increased $12.4 million, primarily related to positions we expect to be taken by the United States Internal Revenue Service (IRS) and the state of Illinois during on-going examinations and appeals.

At December 31, 2008, unrecognized tax benefits of $4.6 million could affect Integrys Energy Group's effective tax rate for continuing operations if recognized in subsequent periods. Also at December 31, 2008, unrecognized tax benefits of $9.5 million related to discontinued operations could affect Integrys Energy Group's effective tax rate if recognized in subsequent periods.

Subsidiaries of Integrys Energy Group file income tax returns in the United States federal jurisdiction, in various United States state and local jurisdictions, and in Canada. Subject to the following major exceptions listed below, Integrys Energy Group is no longer subject to United States federal, state and local, or foreign income tax examinations by tax authorities for years prior to 2003.

- Wisconsin Department of Revenue – WPS has agreed to statute extensions for tax years covering 2001 and 2002.
- New York State Department of Revenue – Integrys Energy Services has the 2002 tax year open for amended returns that were filed.
- Oregon Department of Revenue – WPS Power Development has an open examination for the 2002 tax year.

In 2008, Integrys Energy Group closed the following examination:

- Oregon Department of Revenue – WPS Power Development, Inc. for the tax year 2001.

Integrys Energy Group has the following open examinations:

- IRS – PEC and consolidated subsidiaries have an open examination for the September 30, 2004, through December 31, 2006, tax years.
- IRS – Integrys Energy Group and consolidated subsidiaries has an open examination for the 2006 and 2007 tax years along with the February 21, 2007, PEC short year.
- Illinois Department of Revenue – PEC and combined subsidiaries have an open examination for the September 30, 2003, through December 31, 2006, tax years.
- Wisconsin Department of Revenue – WPS has an open examination for the 2001-2006 tax years.
- New York State Department of Revenue – WPS Energy Services and WPS Power Development have open examinations for the 2004 and 2005 tax years. Also, Integrys Energy Services has the 2002 and 2003 tax years open for amended returns that were filed.
- Oregon Department of Revenue – WPS Energy Services has an open examination for the 2005 tax year; WPS Power Development has an open examination for the 2002, 2003, and 2004 tax years.

In the next 12 months, it is reasonably possible that Integrys Energy Group and its subsidiaries will settle their open examinations in multiple taxing jurisdictions related to tax years prior to 2006, resulting in a decrease in unrecognized tax benefits of as much as $11.6 million.

NOTE 15—COMMITMENTS AND CONTINGENCIES

Commodity Purchase Obligations and Purchase Order Commitments

Integrys Energy Group routinely enters into long-term purchase and sale commitments that have various quantity requirements and durations. The regulated natural gas utilities have obligations to distribute and sell natural gas to their customers, and the regulated electric utilities have obligations to distribute and sell electricity to their customers. The utilities expect to recover costs related to these obligations in future customer rates. Additionally, the majority of the energy supply contracts entered into by our nonregulated segment, Integrys Energy Services, are to meet its obligations to deliver energy to customers.

The obligations described below are as of December 31, 2008.

- The electric utility segment has obligations related to coal supply and transportation that extend through 2016 and total $598.2 million, obligations of $1.3 billion for either capacity or energy related to purchased power that extend through 2027, and obligations for other commodities totaling $14.3 million, which extend through 2013.
- The natural gas utility segment has obligations related to natural gas supply and transportation contracts totaling $1.3 billion, some of which extend through 2028.
- Integrys Energy Services has obligations related to energy and natural gas supply contracts that extend through 2018 and total $4.0 billion. The majority of these obligations end by 2011, with obligations totaling $269.4 million extending beyond 2012.
- Integrys Energy Group also has commitments in the form of purchase orders issued to various vendors, which totaled $626.8 million and relate to normal business operations, as well as large construction projects.

Environmental

United States Environmental Protection Agency (EPA) Section 114 Request

In 2000, WPS received a request from the EPA under Section 114 of the Clean Air Act, seeking information related to work performed on the coal-fired boilers located at WPS's Pulliam and Weston electric generation stations. WPS filed a response with the EPA in early 2001.

In May 2002, WPS received a follow-up request from the EPA seeking additional information regarding specific boiler-related work performed on Pulliam Units 3, 5, and 7, as well as information on WPS's life extension program for Pulliam Units 3-8 and Weston Units 1 and 2. WPS filed a final response to the EPA's follow-up request in June 2002.

In 2000 and 2002, Wisconsin Power and Light Company (WP&L) received a similar series of EPA information requests relating to work performed on certain coal-fired boilers and related equipment at the Columbia generation station (a facility located in Portage, Wisconsin, jointly owned by WP&L, Madison Gas and Electric Company, and WPS). WP&L is the operator of the plant and is responsible for responding to governmental inquiries relating to the operation of the facility. WP&L filed its response for the Columbia facility in July 2002.

Depending upon the results of the EPA's review of the information provided by WPS and WP&L, the EPA may perform any of the following:

- issue notices of violation (NOV) asserting that a violation of the Clean Air Act occurred,
- seek additional information from WPS, WP&L, and/or third parties who have information relating to the boilers, and/or
- close out the investigation.

In addition, under the Clean Air Act, citizen groups may pursue a claim. WPS has no notice of such a claim based on the information submitted to the EPA.

To date, the EPA has not responded to the 2001 and 2002 filings made by WPS and WP&L. However, in March 2008, a data request was received from the EPA seeking information related to operations and projects for the Pulliam and Weston coal-fired boilers from January 2000 to the present. WPS has submitted its response. In December 2008, WP&L received a similar data request and is preparing its response.

In response to the EPA's Clean Air Act enforcement initiative, several utilities elected to settle with the EPA, while others are in litigation. The fines and penalties (including the cost of supplemental environmental projects) associated with settlements involving comparably-sized facilities range between $7 million and $30 million. The regulatory interpretations upon which the lawsuits or settlements are based may change based on future court decisions of the pending litigations.

If the federal government brings a claim against WPS and if it were determined by a court that historic projects at WPS's Pulliam and Weston plants required either a state or federal Clean Air Act permit, WPS may, under the applicable statutes, be required to:

- shut down any unit found to be operating in non-compliance,
- install additional pollution control equipment,
- pay a fine, and/or
- pay a fine and conduct a supplemental environmental project in order to resolve any such claim.

Pulliam Air Notice of Violation

In September 2007, an NOV was issued to WPS by the Wisconsin Department of Natural Resources (WDNR) alleging various violations of the Pulliam facility's Title V permit, primarily pertaining to certain recordkeeping and monitoring requirements. WPS met with the WDNR in November 2007 to discuss and attempt to resolve the matters identified in the NOV, and subsequently submitted additional information pursuant to the WDNR's request. While not finally confirmed by the WDNR, WPS understands that this issue is essentially resolved.

Weston 4 Air Permit

In November 2004, the Sierra Club filed a petition with the WDNR under Section 285.61 of the Wisconsin Statutes seeking a contested case hearing on the construction permit issued for the Weston 4 generation station, which is a necessary predicate to plant construction under the pertinent air emission regulations (hereinafter referred to as the "Weston 4 air permit"). In February 2006, the administrative law judge affirmed the Weston 4 air permit with changes to the emission limits for sulfur dioxide and nitrogen oxide from the coal-fired boiler and particulate from the cooling tower. The changes, which were implemented by the WDNR in a revised permit issued on March 28, 2007, set limits that are more stringent than those originally set by the WDNR (hereinafter referred to as the "March 28, 2007, permit language").

On April 27, 2007, the Sierra Club filed a second petition requesting a contested case hearing regarding the March 28, 2007, permit language, which was granted by the WDNR. Both parties subsequently moved for summary judgment. In a decision issued on November 8, 2007, the administrative law judge granted WPS's motion for summary judgment in that proceeding, upholding the March 28, 2007, permit language. The Sierra Club filed petitions with the Dane County Circuit Court on April 27, 2007, and November 14, 2007, for judicial review of the Weston 4 air permit and the underlying proceedings before the administrative law judge. These two judicial review proceedings were consolidated by the Court. On February 12, 2009, the Court upheld the administrative law judge's final order, which affirmed the WDNR's actions. The Sierra Club has 30 days to appeal this decision.

These activities did not stay the construction and startup of the Weston 4 facility or the administrative law judge's decision on the Weston 4 air permit. WPS believes that it has substantial defenses to the Sierra Club's challenges. Until the Sierra Club's challenge is finally resolved, Integrys Energy Group will not be able to make a final determination of the probable cost impact, if any, of compliance with any changes to the Weston 4 air permit on its future costs.

In December 2008, an NOV was issued to WPS by the WDNR alleging various violations of the air permits for Weston 4, as well as Weston 1 and 2. The alleged violations include an exceedance of the carbon monoxide and volatile organic compound limits at Weston 4, exceedances of the hourly sulfur dioxide limit in ten 3-hour periods during startup/shutdown and during one separate event at Weston 4, and two that address baghouse operation at Weston 1 and 2. Corrective actions have been taken. An enforcement conference was held on January 7, 2009. It is likely that the WDNR will refer the NOV to the state Justice Department for enforcement. Management does not believe that this will have a material adverse impact on the results of operations of Integrys Energy Group.

Weston Operating Permits

In early November 2006, it came to the attention of WPS that previous ambient air quality computer modeling done by the WDNR for the Weston facility (and other nearby air sources) did not take into account the emissions from the existing Weston 3 facility for purposes of evaluating air quality increment consumption under the required Prevention of Significant Deterioration. WPS believes it has undertaken and completed corrective measures to address any identified modeling issues and anticipates issuance of a revised Title V permit in the near future that will resolve this issue. Integrys Energy Group currently is not able to make a final determination of the probable cost impact of this issue, if any.

In December 2008, an NOV was issued to WPS by the WDNR that includes alleged violations of the air permit at Weston 1 and 2 related to the operation of the baghouses. This NOV is discussed above under "Weston 4 Air Permit."

Mercury and Interstate Air Quality Rules

Mercury

The state of Wisconsin has recently revised the state mercury rule, Chapter NR 446. The revised rule requires a 40% reduction from the 2002 through 2004 baseline beginning January 1, 2010, through the end of 2014. Beginning in 2015, electric generating units above 150 megawatts will be required to reduce emissions by 90%. Reductions can be phased in and the 90% target can be delayed until 2021 if additional sulfur dioxide and nitrogen oxide reductions are implemented. By 2015, electric generating units above 25 megawatts but less than 150 megawatts must reduce their mercury emissions to a level defined as the Best Available Control Technology rule. WPS estimates capital costs of approximately $26 million for phase one, which includes estimates for both wholly owned and jointly owned plants, to achieve the required reductions. The capital costs are expected to be recovered in future rate cases. Following the promulgation of a federal mercury control and monitoring rule in 2005 by the EPA, the state of Wisconsin filed suit along with other states in opposition of the rule. On February 8, 2008, the United States Court of Appeals for the District of Columbia Circuit ruled in favor of the petitioners and vacated the federal rule. In May 2008, the EPA's appeal of the ruling was denied. The EPA is reviewing options for a new rulemaking.

Sulfur Dioxide and Nitrogen Oxide
The EPA issued the Clean Air Interstate Rule, formerly known as the Interstate Air Quality Rule (CAIR), in 2005. The rule was originally intended to reduce sulfur dioxide and nitrogen oxide emissions from utility boilers located in 29 states, including Wisconsin, Michigan, Pennsylvania, and New York. The CAIR required reduction of sulfur dioxide and nitrogen oxide emissions in two phases. The first phase required about a 50% reduction beginning in 2009 for nitrogen oxide and beginning in 2010 for sulfur dioxide. The second phase was to begin in 2015 for both pollutants and required about a 65% reduction in emissions. The rule allowed the state of Wisconsin to either require utilities located in the state to participate in the EPA's interstate cap and trade program or meet the state's emission budget for sulfur dioxide and nitrogen oxide through measures to be determined by the state. Wisconsin's rule, which incorporates the cap and trade approach, had completed the state legislative review and had been forwarded to the EPA for final review.

On July 11, 2008, the United States Court of Appeals for the District of Columbia issued a decision vacating the CAIR and the associated Federal Implementation Plan. The EPA requested a rehearing of the decision by the Court of Appeals. On December 23, 2008, the Court of Appeals reversed the CAIR vacatur and thus CAIR has been reinstated. The court also directed the EPA to address the deficiencies noted in its July 11, 2008, ruling.

Prior to the court's vacatur decision, WPS was evaluating a number of options, including using the allowance cap and trade program and/or installing controls. Following the vacatur, WPS put its allowance trading activities on hold. Now with the reinstatement of CAIR, WPS has been re-analyzing its options. WPS does not currently own any annual nitrogen oxide emission allowances beyond those allocated by the state, but has taken delivery of a small number of additional ozone season nitrogen oxide allowances since the reinstatement of CAIR. WPS does not expect any material impact as a result of the vacatur and subsequent reinstatement of the CAIR with respect to nitrogen oxide emission allowances. WPS has been authorized by the PSCW to defer in 2009 purchases of nitrogen oxide emission allowances, which are estimated to be $20 million.

The reinstatement of CAIR has also affected the status of the Best Available Retrofit Technology rule. The WDNR position, as well as the status of WPS units, under that rule is currently being evaluated.

For planning purposes, it is still assumed that additional sulfur dioxide and nitrogen oxide controls will be needed on existing units. The installation of any controls will need to be scheduled as part of WPS's long-term maintenance plan for its existing units. As such, controls may need to be installed before 2015. On a preliminary basis, and assuming controls are still required, WPS estimates capital costs of $523 million, which includes estimates for both wholly owned and jointly owned plants, in order to meet an assumed 2015 compliance date. This estimate is based on costs of current control technology and current information regarding the final state and federal rules. The capital costs are anticipated to be recovered in future rate cases.

Manufactured Gas Plant Remediation
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 and, as such, are responsible for the environmental impacts at 55 manufactured gas plant sites located in Wisconsin, Michigan, and Illinois. All are former regulated utility sites and are being remediated, with costs charged to existing ratepayers at WPS, MGU, PGL, and NSG. Eight of these sites have been transferred to the EPA Superfund Alternative Sites Program, and 11 sites have been transferred to the EPA's Superfund Removal Program. On November 4, 2008, the 11 sites were transferred to the EPA Superfund Alternative Sites Program. Integrys Energy Group estimated and accrued for $639.0 million of future undiscounted investigation and cleanup costs as of December 31, 2008. Integrys Energy Group recorded a regulatory asset of $679.9 million, which is net of insurance recoveries received of $54.4 million, related to the recovery of both unrecovered expenditures and estimated future expenditures as of December 31, 2008.

The natural gas utilities are coordinating the investigation and the cleanup of the manufactured gas plant sites under what is called a "multi-site" program. This program involves prioritizing the work to be done at the sites, preparation and approval of documents common to all of the sites, and utilization of a consistent approach in selecting remedies.

The EPA has identified NSG as a potentially responsible party (PRP) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), at the Waukegan Coke Plant Site located in Waukegan, Illinois (Waukegan Site). The Waukegan Site is part of the Outboard Marine Corporation (OMC) Superfund Site. The EPA also identified OMC, General Motors Corporation, and certain other parties as PRPs at the Waukegan Site. NSG and the other PRPs are parties to a consent decree that requires NSG and General Motors, jointly and severally, to perform the remedial action and establish and maintain financial assurance of $27.0 million (in the form of certain defined net worth levels that NSG has met). The soil component of the remedial action was completed in August 2005. The final design for the groundwater component of the remedial action has been completed, and construction of the groundwater treatment plan was completed in August 2008. Operation of the groundwater treatment unit began in September 2008 and is expected to be up to full capacity during the first quarter of 2009. The EPA reduced the financial assurance requirement to $21.0 million to reflect completion of the soil component of the remedial action.

With respect to portions of certain sites in the city of Chicago (Chicago), PGL received demands from site owners and others asserting standing regarding the investigation or remediation of their parcels. Some of these demands seek to require PGL to perform extensive investigations or remediations. These demands include notice letters sent to PGL by River Village West. In April 2005, River Village West filed suit against PGL in the United States District Court for the Northern District of Illinois under Resource Conservation and Recovery Act (RCRA). The suit, River Village West LLC et al. v. The Peoples Gas Light and Coke Company, No. 05-C-2103 (N.D. Ill. 2005) (RVW II), seeks an order directing PGL to remediate three former sites: the former South Station, the former Throop Street Station, and the former Hough Place Station.

In August 2006, a member of River Village West individually filed suit against PGL in the United States District Court for the Northern District of Illinois under the RCRA. The suit, Thomas A. Snitzer v. The Peoples Gas Light and Coke Company, No. 06-C-4465 (N.D. Ill. 2006) (Snitzer I), seeks an order directing PGL to remediate the Willow Street Station former manufactured gas plant site, which is located along the Chicago River. In October 2006, the same individual filed another suit in the United States District Court for the Northern District of Illinois under RCRA and CERCLA. The suit, Thomas A. Snitzer v. The Peoples Gas Light and Coke Company, No. 06-C-5901 (N.D. Ill. 2006) (Snitzer II), seeks an order directing PGL to remediate four former manufactured gas plant sites, which are located on or near the Chicago River: 22nd Street Station, Division Street Station, Hawthorne Station, and North Shore Avenue Station. This individual also notified PGL of his intent to file suit under RCRA and CERCLA seeking an order directing PGL to remediate two other such sites: Calumet Station and North Station.

In February 2007, Snitzer I and Snitzer II were consolidated with the RVW II case. In June 2007, PGL filed a motion to dismiss, or in the alternative, stay the consolidated litigation on the basis of the transfer of the sites at issue in the litigation to the EPA Superfund Removal Program. On September 28, 2007, the federal district court issued a ruling staying the litigation "pending the conclusion of the United States EPA actions" at these sites. The plaintiffs filed a motion for reconsideration. The court reconsidered the stay and on September 25, 2008, granted PGL's motion for a judgment on the pleadings dismissing the suit. On October 24, 2008, the plaintiffs appealed the district court's ruling. The parties have now agreed to terms of a settlement and upon execution of the settlement documents and implementation of the settlement terms, this matter will be dismissed. The amount of the settlement was not material to Integrys Energy Group.

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. Accordingly, management believes that the costs incurred in connection with former manufactured gas plant operations will not have a material adverse effect on the financial position or results of operations of Integrys Energy Group.

Flood Damage

In May 2003, a fuse plug at the Silver Lake reservoir owned by UPPCO was breached. This breach resulted in subsequent flooding downstream on the Dead River, which is located in Michigan's Upper Peninsula near Marquette, Michigan. Several lawsuits were filed related to this incident, all of which have been settled and for which insurance recovery was received in excess of the applicable self-insured retention.

UPPCO has completed significant environmental restoration activities and is working with the Michigan Department of Environmental Quality to determine what additional activities and mitigation projects are necessary to resolve the impacts associated with this event. Integrys Energy Group maintains a comprehensive insurance program that includes UPPCO that it believes is sufficient to cover its responsibilities related to this event. The self-insured retention on this policy is not material to Integrys Energy Group.

As part of UPPCO's 2009 Power Supply Cost Recovery Plan filing with the Michigan Public Service Commission (MPSC) on September 30, 2008, UPPCO filed for recovery of the remaining deferred replacement power costs related to the Silver Lake incident. Through December 31, 2008, UPPCO deferred replacement power costs of $3.2 million, non-fuel operating and maintenance costs of $0.8 million, and estimated related carrying costs of $0.6 million. UPPCO offset all of the non-fuel operating and maintenance costs and related carrying costs, as well as a portion of the replacement power costs, with a settlement of $2.2 million received from third parties involved in the Silver Lake incident. The remaining replacement power cost requested for recovery from Michigan retail customers is $2.4 million.

The reconstruction of the Silver Lake dam was completed in November 2008. This included a new concrete spillway and a new earthen dam with monitoring instrumentation. The Federal Energy Regulatory Commission (FERC) and Board of Consultants were on site and certified the completion. UPPCO has submitted a refill and operations plan for FERC approval. Once the refill plan is approved by the FERC, the reservoir can be refilled. It is expected to take approximately two years to return the reservoir to normal operation. Cost recovery for rebuilding the Silver Lake facility will be the subject of a future rate proceeding.

Greenhouse Gases

There is increasing concern over the issue of climate change and the effect of emissions of greenhouse gases, in particular from the combustion of fossil fuels. Integrys Energy Group is evaluating both the technical and cost implications which may result from future state, regional, or federal greenhouse gas regulatory programs. This evaluation indicates that it is probable that any regulatory program that caps emissions or imposes a carbon tax will increase costs for Integrys Energy Group and its customers. The greatest impact is likely to be on fossil fuel-fired generation, with a less significant impact on natural gas storage and distribution operations. Efforts are underway within the utility industry to find a feasible method for capturing carbon dioxide from pulverized coal-fired units and to develop cleaner ways to burn coal. The use of alternate fuels is also being explored by the industry, but there are many cost and availability issues. Recently there have been efforts initiated to develop state and regional greenhouse gas programs. There are also renewed efforts to create federal legislation to limit carbon dioxide emissions and to create national renewable portfolio standards. A risk exists that such legislation will increase the cost of energy. However, we believe the capital expenditures we are making at our generation units are appropriate under any reasonable mandatory greenhouse gas program and that future expenditures by our 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 regulatory actions.

Escanaba Water Permit Issues

UPPCO operates the Escanaba Generating Station (EGS) under contract with its owner, the city of Escanaba (City). While the City owns the water permits for EGS, UPPCO's personnel provide testing and certification of waste water discharges. In September 2008, UPPCO became aware of potential water discharge permit violations regarding reported pH and oil and grease readings at EGS. Corrective actions have been implemented at the plant, notification has been provided to the City, and UPPCO has self reported the potential permit violations to the Michigan Department of Environmental Quality (MDEQ). A final report was filed by UPPCO with the MDEQ on November 25, 2008, and a copy was sent to the City.

Depending upon the results of the MDEQ's review of the information provided by UPPCO, the MDEQ, in consultation with the Michigan Attorney General Office, may perform any of the following:

- assess a fine and/or seek criminal charges against UPPCO,
- assess a fine and/or seek criminal charges against the former manager who certified the reports, and/or
- close out the investigation.

Natural Gas Charge Reconciliation Proceedings and Related Matters

Natural Gas Charge Settlement

For PGL and NSG, the ICC conducts annual proceedings regarding the reconciliation of revenues from the natural gas charge and related natural gas costs. The natural gas charge represents the cost of natural gas and transportation and storage services purchased by PGL and NSG, as well as gains, losses, and costs incurred under PGL's and NSG's hedging program (Gas Charge). In these proceedings, interested parties review the accuracy of the reconciliation of revenues and costs and the prudence of natural gas costs recovered through the Gas Charge. If the ICC were to find that the reconciliation was inaccurate or any natural gas costs were imprudently incurred, the ICC would order the utility companies to refund the affected amount to customers through subsequent Gas Charge filings.

In March 28, 2006, orders, the ICC adopted a settlement agreement related to fiscal years 2001 through 2004 natural gas costs. Under certain provisions of the settlement agreement, PEC agreed to provide the Illinois Attorney General (AG) and Chicago up to $30.0 million for conservation and weatherization programs for which PGL and NSG may not seek rate recovery. PGL and NSG also agreed to implement a reconnection program for customers identified as hardship cases on the date of the agreement. Finally, PGL and NSG agreed to internal audits and an external audit of natural gas supply practices.

With respect to the conservation and weatherization funding, as of December 31, 2008, $15.2 million remained unpaid, of which $5.2 million was included in other current liabilities, and $10.0 million was included in other long-term liabilities. Under the reconnection program, PGL and NSG reconnected customers who participated in the program and took other steps required by the agreement. The AG and Chicago have indicated that they believe the terms of the reconnection program are broader than what PGL and NSG implemented. Management continues to believe that it has fully complied with the reconnection program obligations of the settlement agreement.

Concerning the audit requirements, two of the five required annual internal audits have been completed. An auditor hired by the ICC conducted the external audit, and the report was filed on April 10, 2008. The report included 32 recommendations, none of which quantified natural gas costs that the auditor believed should not be recovered by PGL and NSG. By March 31, 2009, PGL and NSG expect to complete their responses to the 25 recommendations they agreed to implement in a June 30, 2008, response to the audit. The ICC staff has not filed a reply to PGL's and NSG's response.

The fiscal 2005 Gas Charge reconciliation cases were initiated in November 2005. The settlement of the prior fiscal years' Gas Charge reconciliation proceedings did not affect these cases, except for PGL's agreement to credit fiscal 2005 hub revenues as an offset to utility customers' natural gas charges. For PGL and NSG, the ICC issued its orders on January 16, 2008. The natural gas cost disallowance for PGL was $20.5 million, and included 2005 hub revenues and an adjustment for transportation customers' bank (storage) natural gas. The natural gas cost disallowance for NSG was $1.0 million, and also related to a bank natural gas adjustment. The customer refunds from the 2005 Gas Charge reconciliation cases were accounted for as a preacquisition contingency. Pursuant to the ICC orders, PGL and NSG refunded customers $22.6 million and $1.1 million, respectively, including interest, during 2008.

The fiscal 2006 Gas Charge reconciliation cases were initiated on November 21, 2006. The ICC staff and interveners (the AG, the Citizens Utility Board, and Chicago, filing jointly) each filed testimony recommending disallowances for PGL and NSG for a bank natural gas adjustment similar to that addressed in the fiscal 2005 Gas Charge reconciliation cases, which PGL and NSG did not contest. In addition, the interveners recommended a disallowance for PGL of $13.9 million (reduced to $11.0 million in their brief) associated with PGL's provision of interstate hub services. The ICC staff does not support the interveners' proposal, and PGL does not believe the proposal has merit. A hearing for the PGL and NSG cases was held on December 11, 2008. For PGL, briefing is scheduled to conclude February 27, 2009, after which the administrative law judge will prepare a proposed order. For NSG, there were no contested issues, and the parties filed an agreed form of order in January 2009.

Class Action

In February 2004, a purported class action was filed in Cook County Circuit Court against PEC, PGL, and NSG by customers of PGL and NSG, alleging, among other things, violation of the Illinois Consumer Fraud and Deceptive Business Practices Act related to matters at issue in the utilities' fiscal year 2001 Gas Charge reconciliation proceedings. In the suit, Alport et al. v. Peoples Energy Corporation, the plaintiffs seek disgorgement and punitive damages. PGL and NSG have been dismissed as defendants and the only remaining counts of the suit allege violations of the Consumer Fraud and Deceptive Business Practices Act by PEC and that PEC acted in concert with others to commit a tortious act. PEC denies the allegations and is vigorously defending the suit. On July 30, 2008, the plaintiffs filed a motion for class certification and PEC responded in opposition of this motion. On October 31, 2008, PEC filed a motion for summary judgment. At the plaintiffs' request, their reply to PEC's class certification response was postponed pending a decision on PEC's summary judgment motion.

Corrosion Control Inspection Proceeding

Illinois state, as well as federal laws, require natural gas utilities to conduct periodic corrosion control inspections on natural gas pipelines. On April 19, 2006, the ICC initiated a citation proceeding related to such inspections that were required to be performed by PGL during 2003 and 2004, but which were not completed in the requisite timeframe. On December 20, 2006, the ICC entered an order approving a stipulation between the parties to this proceeding under which PGL agreed that it had not been in compliance with applicable regulations, and further agreed to pay a penalty of $1.0 million, pay for a consultant to conduct a comprehensive investigation of its compliance with ICC pipeline safety regulations, remain compliant with those regulations, not seek recovery in future rate cases of certain costs related to non-compliance, and hold meetings with Chicago to exchange information. This order resolved only the ICC proceeding and did not constitute a release of any other potential actions outside of the ICC proceeding. With respect to the comprehensive investigation, the ICC selected an auditor for this matter and the auditor, issued a final report on August 14, 2008, containing 65 recommendations and an additional placeholder for a possible recommendation. The ICC conducted a public hearing on October 8, 2008, at which time the auditor presented the report to the ICC for its acceptance. PGL submitted a draft plan to the ICC staff in which PGL accepted most of the recommendations and offered an alternative proposal for the remainder. At a subsequent meeting and in concurrence with the ICC staff and the consultant, PGL has revised its implementation plan for some of the recommendations. The auditor's agreement with the ICC provides for a two-year monitoring phase to verify PGL's compliance with the prospective implementation plan, which began in January 2009.

On May 16, 2006, the AG served a subpoena requesting documents relating to PGL's corrosion inspections. PGL's counsel has met with representatives of the AG's office and provided documents relating to the subpoena. On July 10, 2006, the United States Attorney for the Northern District of Illinois served a grand jury subpoena on PGL requesting documents relating to PGL's corrosion inspections. PGL's counsel has met with the United States Attorney's office and provided documents relating to corrosion inspections. PGL has had no further communication with the United States Attorney's office since that time. Management cannot predict the outcome of this investigation and has not recorded a liability associated with this contingency.

Builders Class Action

In June 2005, a purported class action was filed against PEC and its utility subsidiaries by Birchwood Builders, LLC in the Circuit Court of Cook County, Illinois alleging that PGL and NSG were fraudulently and improperly charging fees to customers with respect to utility connections, disconnections, reconnections, relocations, extensions of natural gas service pipes, extensions of distribution natural gas mains, and failing to return related customer deposits. In November 2008, Integrys Energy Group, PEC, PGL, and NSG (the companies) entered into a settlement agreement with the plaintiffs. The settlement amount was not material to the companies. The plaintiffs filed a motion to dismiss their appeal, which was granted by the appellate court on December 5, 2008. This matter is now resolved.

NOTE 16—GUARANTEES

As part of normal business, Integrys Energy Group and its subsidiaries enter into various guarantees providing financial or performance assurance to third parties on behalf of certain subsidiaries. These guarantees are entered into primarily to support or enhance the creditworthiness otherwise attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes.

Most of the guarantees issued by Integrys Energy Group include inter-company guarantees between parents and their subsidiaries, which are eliminated in consolidation, and guarantees of the subsidiaries' own performance. As such, these guarantees are excluded from the recognition and measurement requirements of FASB Interpretation No. 45.

The following table shows outstanding guarantees at Integrys Energy Group at December 31, 2008:

		Expiration			
(Millions)	**Total Amounts Committed at December 31, 2008**	**Less Than 1 Year**	**1 to 3 Years**	**4 to 5 Years**	**Over 5 Years**
Guarantees supporting commodity transactions of subsidiaries [1]	**$2,156.5**	**$1,607.1**	**$ 448.9**	**$19.2**	**$ 81.3**
Guarantees of subsidiary debt and revolving line of credit [2]	**928.1**	**175.0**	**725.0**	**–**	**28.1**
Standby letters of credit [3]	**403.6**	**389.7**	**13.9**	**–**	**–**
Surety bonds [4]	**3.5**	**3.5**	**–**	**–**	**–**
Other guarantees [5]	**3.8**	**1.5**	**2.3**	**–**	**–**
Total guarantees	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[1] *Consists of parental guarantees of $1,981.3 million to support the business operations of Integrys Energy Services, of which $5.0 million received specific authorization from Integrys Energy Group's Board of Directors and was not subject to the guarantee limit discussed below; $88.4 million and $81.8 million, respectively, related to natural gas supply at MERC and MGU, of an authorized $150.0 million and $100.0 million, respectively; and $5.0 million, of an authorized $125.0 million, to support business operations at PEC. These guarantees are not reflected in the Consolidated Balance Sheets.*

[2] *Consists of agreements to fully and unconditionally guarantee (1) PEC's $400.0 million revolving line of credit; (2) on a senior unsecured basis, PEC's obligations under its $325.0 million, 6.90% notes due January 15, 2011; (3) Integrys Energy Services' $175.0 million credit agreement used to finance natural gas in storage and margin requirements related to natural gas and electric contracts traded on the NYMEX and the Intercontinental Exchange, as well as for general corporate purposes; and (4) $28.1 million supporting outstanding debt at Integrys Energy Services' subsidiaries, of which $1.1 million is subject to Integrys Energy Services' parental guarantee limit discussed below. Parental guarantees related to subsidiary debt and credit agreements outstanding are not included in the Consolidated Balance Sheets.*

[3] *Comprised of $398.4 million issued to support Integrys Energy Services' operations, including $2.5 million that received specific authorization from Integrys Energy Group's Board of Directors; $4.3 million issued for workers compensation coverage in Illinois; and $0.9 million related to letters of credit at UPPCO, MGU, MERC, and PEC. These amounts are not reflected in the Consolidated Balance Sheets.*

[4] *Primarily for workers compensation coverage and obtaining various licenses, permits, and rights of way. Surety bonds are not included in the Consolidated Balance Sheets.*

[5] *Includes (1) a liability related to WPS's agreement to indemnify Dominion for certain costs arising from the resolution of design basis documentation issues incurred prior to Kewaunee nuclear power plant's scheduled maintenance period in 2009. As of December 31, 2008, WPS had paid $7.4 million to Dominion related to this guarantee, reducing the liability to $1.5 million. WPS expects to make payments for the entire remaining liability amount over the duration of the guarantee; and (2) a $2.3 million indemnification provided by Integrys Energy Services related to the sale of Niagara. This indemnification related to potential environmental contamination from ash disposal at this facility. Integrys Energy Services expects that the likelihood of required performance under this guarantee is remote.*

Integrys Energy Group has provided total parental guarantees of $2,584.3 million on behalf of Integrys Energy Services. Integrys Energy Group's exposure under these guarantees related to open transactions at December 31, 2008, was approximately $837 million. At December 31, 2008, management was authorized to issue corporate guarantees up to an aggregate amount of $2.95 billion to support the business operations of Integrys Energy Services. The following outstanding amounts were subject to this limit:

(Millions)	[illegible]
Guarantees supporting commodity transactions of subsidiaries	[illegible]
Guarantees of subsidiary debt	[illegible]
Standby letters of credit	[illegible]
Surety bonds	[illegible]
Total guarantees subject to $2.95 billion limit	[illegible]

NOTE 17—EMPLOYEE BENEFIT PLANS

Defined Benefit Plans

On September 30, 2008, the PEC Service Annuity System was merged into the PEC Retirement Plan, which was then renamed the Integrys Energy Group Retirement Plan. On December 31, 2008, the WPS Retirement Plan was merged into the Integrys Energy Group Retirement Plan. The two plan mergers had no effect on the level of plan benefits provided to participants or the management of plan assets. Integrys Energy Group and its subsidiaries now maintain one non-contributory, qualified pension plan covering substantially all employees, as well as several unfunded nonqualified retirement plans. In addition, Integrys Energy Group and its subsidiaries offer multiple other postretirement benefit plans to employees. The benefits for a portion of these plans are funded through irrevocable trusts, as allowed for income tax purposes.

Integrys Energy Group also currently offers medical, dental, and life insurance benefits to employees and their dependents. Integrys Energy Group expenses the costs of these benefits for active employees as incurred.

During the third quarter of 2007, Integrys Energy Group made a series of changes to certain of its retirement benefit plans. Specifically, the changes included:

- Closure of the defined benefit pension plans to non-union new hires, effective January 1, 2008;
- A freeze in defined benefit pension service accruals for non-union employees, effective January 1, 2013;
- A freeze in compensation amounts used for determining defined benefit pension amounts for non-union employees, effective January 1, 2018;
- Revised eligibility requirements for retiree medical benefits for employees hired on or after January 1, 2008, and the introduction of an annual premium reduction credit for employees eligible to retire after December 31, 2012; and
- Closure of the retiree dental and life benefit programs to all new hires, effective January 1, 2008, and elimination of these benefits for any existing employees who are not eligible to retire before December 31, 2012.

As a result of the changes described above, Integrys Energy Group remeasured certain of its pension and other postretirement benefit obligations as of August 1, 2007. The curtailment gains and losses recognized as a result of the plan design changes were not significant and are included in the table below.

A second remeasurement occurred on October 1, 2007, because the ratification of a union contract resulted in changes to a postretirement medical plan. The changes did not result in a curtailment.

Effective May 1, 2008, and July 1, 2008, the defined benefit pension plans were closed to new union hires at PGL and NSG, respectively. Effective April 19, 2009, the defined benefit pension plans will be closed to new union hires at UPPCO.

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets during 2008 and 2007.

	Pension Benefits		Other Benefits	
Reconciliation of benefit obligation ***(Millions)***	**2008**	**2007**	**2008**	**2007**
Obligation at January 1	$1,210.2	$ 787.3	$408.6	$292.1
Service cost	38.4	39.7	15.7	15.4
Interest cost	70.2	70.4	26.4	24.5
Plan amendments	–	–	–	(21.4)
Plan curtailments	–	(0.7)	–	(0.6)
Plan acquisitions – PEC	–	498.1	–	156.7
Actuarial (gain) loss, net	12.1	(96.0)	[illegible]	(43.0)
Participant contributions	–	–	[illegible]	6.0
Benefit payments	(106.4)	(88.6)	[illegible]	(22.8)
Federal subsidy on benefits paid	–	–	2.0	1.7
Other	–	–	[illegible]	–
Obligation at December 31	[illegible]	$1,210.2	[illegible]	$408.6

	Pension Benefits		Other Benefits	
Reconciliation of fair value of plan assets ***(Millions)***	**2008**	**2007**	**2008**	**2007**
Fair value of plan assets at January 1	$1,219.5	$ 674.0	[illegible]	$212.8
Actual return on plan assets	(310.6)	68.9	[illegible]	14.5
Employer contributions	27.8	27.4	13.6	7.9
Participant contributions	–	–	1.7	6.0
Plan acquisitions – MGU and MERC	–	0.2	–	–
Plan acquisitions – PEC	–	537.6	–	29.7
Benefit payments	(104.4)	(88.6)	[illegible]	(22.6)
Other	–	–	[illegible]	–
Fair value of plan assets at December 31	[illegible]	$1,219.5	[illegible]	$248.3

Amounts recognized in Integrys Energy Group's Consolidated Balance Sheets at December 31 related to the funded status of the benefit plans consisted of:

(Millions)	Pension Benefits		Other Benefits	
	[illegible]	2007	[illegible]	2007
Noncurrent assets	$ –	$98.7	$ –	$ 2.7
Current liabilities	[illegible]	4.4	–	0.1
Noncurrent liabilities	[illegible]	85.0	[illegible]	162.9
Net liability (asset)	[illegible]	$ (9.3)	[illegible]	$160.3

The accumulated benefit obligation for all defined benefit pension plans was $1.1 billion at both December 31, 2008, and December 31, 2007. Information for pension plans with an accumulated benefit obligation in excess of plan assets is presented in the table at right.

(Millions)	December 31,	
	[illegible]	2007
Projected benefit obligation	[illegible]	$276.0
Accumulated benefit obligation	[illegible]	240.4
Fair value of plan assets	[illegible]	193.3

The following table shows the amounts that had not yet been recognized in Integrys Energy Group's net periodic benefit cost as of December 31. Amounts related to the nonregulated entities are included in accumulated other comprehensive income (loss), while amounts related to the utilities are recorded as regulatory assets or liabilities.

(Millions)	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
Accumulated other comprehensive income (loss) (pre-tax)				
Net actuarial loss	$ 25.7	$ 3.5	$ 0.7	$ 0.9
Prior service costs (credits)	1.2	1.5	(2.2)	(2.6)
Total	$ 26.9	$ 5.0	$ (1.5)	$ (1.7)
Net regulatory assets				
Net actuarial loss (gain)	[illegible]	$ (16.5)	$56.1	$(10.4)
Prior service costs (credits)	22.9	27.7	(26.9)	(30.3)
Transition obligation	–	–	1.1	1.3
Merger related regulatory adjustment	91.5	89.4	42.0	44.6
Total	[illegible]	$100.6	[illegible]	$ 5.2

Integrys Energy Group recorded the PEC pension assets acquired and liabilities assumed at fair value at the February 2007 acquisition date. However, PGL and NSG continue to have rates set based on their historical basis of accounting, including amortizations of prior service cost (credits), actuarial losses, and transition obligations, which were recognized in the Consolidated Financial Statements as regulatory assets at the purchase date. The amount reflected in net periodic benefit cost in the table below is based on the amount used in the rate-setting process for PGL and NSG. The difference in the basis of accounting is shown as a merger related regulatory adjustment in the table above.

The estimated net losses and prior service costs for defined benefit pension plans that will be amortized as a component of net periodic benefit cost during 2009 are $0.4 million and $5.0 million, respectively. The estimated net losses, prior service costs, and transition obligation for other postretirement benefit plans that will be amortized as a component of net periodic benefit cost during 2009 are $1.2 million, $3.8 million, and $0.3 million, respectively. The estimated merger related regulatory adjustment that will be amortized as a component of net periodic benefit cost for defined pension and other postretirement benefit plans during 2009 is $4.8 million and $2.0 million, respectively.

The following table presents the components of the consolidated net periodic benefit cost for the plans:

(Millions)	Pension Benefits			Other Benefits		
	[redacted]	2007	2006	[redacted]	2007	2006
Net periodic benefit cost						
Service cost	[redacted]	$39.7	$24.2	[redacted]	$15.4	$ 7.1
Interest cost	[redacted]	70.4	42.1	[redacted]	24.5	17.3
Expected return on plan assets	[redacted]	(89.4)	(44.2)	[redacted]	(17.5)	(13.5)
Plan curtailments (gain) loss	[redacted]	–	–	[redacted]	(0.1)	–
Amortization of transition obligation	[redacted]	–	0.2	[redacted]	0.4	0.4
Amortization of prior service cost (credit)	[redacted]	5.1	5.1	[redacted]	(2.6)	(2.2)
Amortization of net loss	[redacted]	4.8	9.8	[redacted]	1.8	5.3
Amortization of merger related regulatory adjustment	[redacted]	14.2	–	[redacted]	0.8	–
Net periodic benefit cost	[redacted]	$44.8	$37.2	[redacted]	$22.7	$14.4

Assumptions—Pension and Other Postretirement Benefit Plans

The weighted-average assumptions used at December 31 to determine benefit obligations for the plans were as follows:

	Pension Benefits		Other Benefits	
	[redacted]	2007	[redacted]	2007
Discount rate	[redacted]	6.40%	[redacted]	6.40%
Rate of compensation increase	[redacted]	4.98%	[redacted]	N/A
Assumed medical cost trend rate (under age 65)	[redacted]	N/A	[redacted]	10.0%
Ultimate trend rate	[redacted]	N/A	[redacted]	5.0%
Ultimate trend rate reached in	[redacted]	N/A	[redacted]	2013
Assumed medical cost trend rate (over age 65)	[redacted]	N/A	[redacted]	10.5%
Ultimate trend rate	[redacted]	N/A	[redacted]	5.5%
Ultimate trend rate reached in	[redacted]	N/A	[redacted]	2013
Assumed dental cost trend rate	[redacted]	N/A	[redacted]	5.0%

The weighted-average assumptions used to determine net periodic benefit cost for the plans were as follows for the years ended December 31:

	Pension Benefits		
	[redacted]	2007	2006
Discount rate	[redacted]	5.88%	5.65%
Expected return on assets	[redacted]	8.50%	8.50%
Rate of compensation increase	[redacted]	5.50%	5.50%
	Other Benefits		
	[redacted]	2007	2006
Discount rate	[redacted]	5.79%	5.65%
Expected return on assets	[redacted]	8.50%	8.50%
Assumed medical cost trend rate (under age 65)	[redacted]	8.0%	9.0%
Ultimate trend rate	[redacted]	5.0%	5.0%
Ultimate trend rate reached in	[redacted]	2010	2010
Assumed medical cost trend rate (over age 65)	[redacted]	8.0%-10.0%	11.0%
Ultimate trend rate	[redacted]	5.0%-6.5%	6.5%
Ultimate trend rate reached in	[redacted]	2010-2011	2011
Assumed dental cost trend rate	[redacted]	5.0%	5.0%

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.

Assumed health care cost trend rates have a significant effect on the amounts reported by Integrys Energy Group for the health care plans. For the year ended December 31, 2008, a one-percentage-point change in assumed health care cost trend rates would have had the following effects:

	One-Percentage-Point	
(Millions)	Increase	Decrease
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	$ 6.7	$ [illegible]
Effect on the health care component of the accumulated postretirement benefit obligation	[illegible]	[illegible]

Pension and Other Postretirement Benefits Plan Assets

The weighted-average asset allocations of the plans at December 31, 2008, and 2007, were as follows:

	Pension Benefits		Other Benefits	
	Percentage of Plan Assets at December 31,		Percentage of Plan Assets at December 31,	
Asset category	**2008**	**2007**	**2008**	**2007**
Equity securities	56%	63%	50%	61%
Debt securities	40%	33%	50%	39%
Real estate	4%	4%	–	–
Total	100%	100%	100%	100%

The target asset allocations for pension plans are as follows: 64% equity securities, 33% debt securities, and 3% real estate. The target asset allocations for other postretirement plans in place prior to the PEC merger for the above listed asset classes are as follows: 65% equity securities and 35% debt securities. The target asset allocations for other postretirement plans acquired in the PEC merger are as follows: 60% equity securities and 40% debt securities. The Board of Directors has established the Employee Benefits Administrator Committee to manage the operations and administration of all benefit plans and trusts. The Committee periodically reviews the asset allocation, and the portfolio is rebalanced when necessary.

Cash Flows Related to Pension and Other Postretirement Benefit Plans

Integrys Energy Group's funding policy is to contribute at least the minimum amounts that are required to be funded under the Employee Retirement Income Security Act, but not more than the maximum amounts that are currently deductible for income tax purposes. Integrys Energy Group expects to contribute $26.1 million to pension plans and $28.3 million to other postretirement benefit plans in 2009.

The following table shows the payments, reflecting expected future service, which Integrys Energy Group expects to make for pension and other postretirement benefits. In addition, the table shows the expected federal subsidies, provided under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, which will partially offset other postretirement benefits.

(Millions)	[redacted]
2009	
2010	
2011	
2012	
2013	
2014-2018	

Defined Contribution Benefit Plans

Integrys Energy Group maintains 401(k) Savings Plans for substantially all full-time employees. Integrys Energy Group matches a percentage of employee contributions through an Employee Stock Ownership Plan (ESOP) contribution up to certain limits. Certain union employees receive a contribution to their ESOP account regardless of their participation in the 401(k) Savings Plan. The ESOP held 2.9 million shares of Integrys Energy Group's common stock (market value of $124.7 million) at December 31, 2008. Certain employees participate in a discretionary profit-sharing contribution and/or cash match. Non-union employees hired after January 1, 2008, are no longer eligible to participate in the defined benefit pension plan. Instead, these employees participate in a defined contribution pension plan, in which Integrys contributes certain amounts to an employee's account based on the employee's wages, age, and years of service. Total costs incurred under all of these plans were $17.4 million in 2008, $14.4 million in 2007, and $9.4 million in 2006.

Integrys Energy Group maintains deferred compensation plans that enable certain key employees and non-employee directors to defer a portion of their compensation or fees on a pre-tax basis. Non-employee directors can defer up to 100% of their director fees. Compensation is generally deferred in the form of cash, indexed to certain investment options, or Integrys Energy Group common stock with deemed dividends paid on the common stock automatically reinvested. Effective March 31, 2008, the investment option of indexing to Integrys Energy Group's return on equity was closed to new contributions.

The deferred compensation arrangements for which distributions are made solely in Integrys Energy Group's common stock are classified as an equity instrument. Changes in the fair value of the deferred compensation obligation are not recognized. The deferred compensation obligation associated with this arrangement was $23.7 million at December 31, 2008, and $24.6 million at December 31, 2007.

The portion of the deferred compensation obligation associated with deferrals that allow for distribution in cash is classified as a liability on the Consolidated Balance Sheets and adjusted, with a charge or credit to expense, to reflect changes in the fair value of the deferred compensation obligation. The obligation classified within other long-term liabilities was $28.2 million at December 31, 2008, and $30.2 million at December 31, 2007. The costs incurred under this arrangement were $1.9 million in 2008, $2.3 million in 2007, and $3.0 million in 2006.

The deferred compensation programs are partially funded through shares of Integrys Energy Group's common stock that is held in a rabbi trust. The common stock held in the rabbi trust is classified as a reduction of equity in a manner similar to accounting for treasury stock. The total cost of Integrys Energy Group's common stock held in the rabbi trust was $16.3 million at December 31, 2008, and $14.7 million at December 31, 2007.

NOTE 18—PREFERRED STOCK OF SUBSIDIARY

Integrys Energy Group's subsidiary, WPS, has 1,000,000 authorized shares of preferred stock with no mandatory redemption and a $100 par value. Outstanding shares were as follows at December 31:

	2008		2007	
(Millions, except share amounts)	**Shares Outstanding**	**Carrying Value**	**Shares Outstanding**	**Carrying Value**
Series				
5.00%	130,695	$13.1	130,714	$13.1
5.04%	29,898	3.0	29,898	3.0
5.08%	49,923	5.0	49,923	5.0
6.76%	150,000	15.0	150,000	15.0
6.88%	150,000	15.0	150,000	15.0
Total	[illegible]	$51.1	510,535	$51.1

All shares of preferred stock of all series are of equal rank except as to dividend rates and redemption terms. Payment of dividends from any earned surplus or other available surplus is not restricted by the terms of any indenture or other undertaking by WPS. Each series of outstanding preferred stock is redeemable in whole or in part at WPS's option at any time on 30 days' notice at the respective redemption prices. WPS may not redeem less than all, nor purchase any, of its preferred stock during the existence of any dividend default.

In the event of WPS's dissolution or liquidation, the holders of preferred stock are entitled to receive (a) the par value of their preferred stock out of the corporate assets other than profits before any of such assets are paid or distributed to the holders of common stock and (b) the amount of dividends accumulated and unpaid on their preferred stock out of the surplus or net profits before any of such surplus or net profits are paid to the holders of common stock. Thereafter, the remainder of the corporate assets, surplus, and net profits shall be paid to the holders of common stock.

The preferred stock has no pre-emptive, subscription, or conversion rights, and has no sinking fund provisions.

NOTE 19—COMMON EQUITY

Integrys Energy Group's reconciliation of shares outstanding at December 31, 2008, and 2007, was as follows:

	2008		2007	
	Shares	**Average Cost**	**Shares**	**Average Cost**
Common stock issued	76,430,037		76,434,095	
Less:				
Treasury shares *	7,000	$25.19	10,000	$25.19
Deferred compensation rabbi trust	357,239	44.36	338,522	43.48
Restricted stock	62,031	54.31	93,339	54.76
Total shares outstanding	[illegible]		75,992,234	

** Relates to Integrys Energy Group's Non-Employee Directors Stock Option Plan. All options under this plan have a ten-year life, but may not be exercised until one year after the date of grant.*

During 2008, Integrys Energy Group purchased shares of its common stock on the open market to meet the requirements of its Stock Investment Plan and certain stock-based employee benefit and compensation plans. Prior to 2008, Integrys Energy Group issued new shares of common stock under these plans. These stock issuances increased equity $45.7 million and $25.0 million in 2007 and 2006, respectively.

Pursuant to the PEC merger, shareholders of PEC received 0.825 shares of Integrys Energy Group (then known as WPS Resources) common stock, $1 par value, for each share of PEC common stock, no par value, that they held immediately prior to the merger. This resulted in an increase in common stock outstanding of 31,938,491 shares and increased equity $1.6 billion as of December 31, 2007.

Rollforward of Integrys Energy Group's Common Stock Shares Issued	
Balance at December 31, 2005	40,089,898
Shares issued	
Stock Investment Plan	406,878
Stock-based compensation	134,392
Common stock offering	2,700,000
Rabbi trust shares	56,292
Balance at December 31, 2006	43,387,460
Shares issued	
Merger with PEC	31,938,491
Stock Investment Plan	529,935
Stock-based compensation	444,041
Restricted stock, net	93,339
Rabbi trust shares	40,829
Balance at December 31, 2007	76,434,095
Restricted stock shares cancelled	[illegible]
Balance at December 31, 2008	[illegible]

Dividends

Integrys Energy Group is a holding company and our ability to pay dividends is largely dependent upon the ability of our subsidiaries to pay dividends to us. In the 2009 rate order, the PSCW has restricted our subsidiary, WPS, to paying normal dividends on its common stock of no more than 103% of the previous year's common stock dividend. 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), which has a common equity range of 49% to 54%. The PSCW has 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. Each of these limitations may be modified by a future order of the PSCW. Our 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 which 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, 2008, these limitations amounted to $1.2 million out of WPS's total retained earnings of $372.0 million. Consequently, at December 31, 2008, WPS had $370.8 million of retained earnings available for the payment of dividends.

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, 2008, these restrictions amounted to $30.5 million out of UPPCO's total retained earnings of $49.1 million. Consequently, at December 31, 2008, UPPCO had $18.6 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, 2008, these restrictions amounted to $6.9 million out of NSG's total retained earnings of $77.4 million. Consequently, at December 31, 2008, NSG had $70.5 million of retained earnings available for the payment of dividends.

For the year ended December 31, 2008, PEC, PGL, MGU, MERC, and Integrys Energy Services did not make any dividend payments.

At December 31, 2008, Integrys Energy Group had $585.8 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.

Earnings Per Share

Basic earnings per share are computed by dividing income available for common shareholders by the weighted average number of common stock shares outstanding during the period. Diluted earnings per share are computed by dividing income available for common shareholders by the weighted average number of common stock shares outstanding during the period, adjusted for the exercise and/or conversion of all potentially dilutive securities. Such dilutive items include in-the-money stock options, performance stock rights, and restricted stock. The calculation of diluted earnings per share for 2008 excluded 2.2 million stock options that were outstanding at December 31, 2008, which had an anti-dilutive effect. The calculation of diluted earnings per share for 2007 and 2006 excludes some insignificant stock options that had an anti-dilutive effect. The following table reconciles the computation of basic and diluted earnings per share:

(Millions, except per share amounts)	[illegible]	2007	2006
Numerator:			
Income from continuing operations	[illegible]	$181.1	$151.6
Discontinued operations, net of tax	[illegible]	73.3	7.3
Preferred stock dividends of subsidiary	[illegible]	(3.1)	(3.1)
Income available for common shareholders	[illegible]	$251.3	$155.8
Denominator:			
Average shares of common stock – basic	[illegible]	71.6	42.3
Effect of dilutive securities			
Stock-based compensation	[illegible]	0.2	0.1
Average shares of common stock – diluted	[illegible]	71.8	42.4
Earnings per common share			
Basic	[illegible]	$3.51	$3.68
Diluted	[illegible]	3.50	3.67

NOTE 20—STOCK-BASED COMPENSATION

In May 2007, Integrys Energy Group's shareholders approved the 2007 Omnibus Incentive Compensation Plan (2007 Omnibus Plan). Under the provisions of the 2007 Omnibus Plan, the number of shares of stock that may be issued in satisfaction of plan awards may not exceed 3,500,000, and no more than 1,500,000 shares of stock can be granted as performance shares or restricted stock. No additional awards will be issued under prior plans, although the plans will continue to exist for purposes of the existing outstanding stock-based compensation. At December 31, 2008, stock options, performance stock rights, restricted shares and restricted share units, and stock appreciation rights were outstanding under the various plans.

Stock Options

Under the provisions of the 2007 Omnibus Plan, no single employee who is the chief executive officer of Integrys Energy Group or any of the other four highest compensated officers of Integrys Energy Group and its subsidiaries can be granted options for more than 1,000,000 shares during any calendar year. No stock options will have a term longer than ten years. The exercise price of each stock option is equal to the fair market value of the stock on the date the stock option is granted. Generally, one-fourth of the stock options granted vest and become exercisable each year on the anniversary of the grant date.

The fair values of stock option awards granted were estimated using a binomial lattice model. The expected term of option awards is calculated based on historical exercise behavior and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate is based on the United States Treasury yield curve. The expected dividend yield incorporates the current dividend rate as well as historical dividend increase patterns. Integrys Energy Group's expected stock price volatility was estimated using its 10-year historical volatility. The following table shows the weighted-average fair values per stock option along with the assumptions incorporated into the valuation models:

	2008	2007	2006
Weighted-average fair value per option		$7.80	$6.04
Expected term		7 years	6 years
Risk-free interest rate		4.65%	4.42%
Expected dividend yield		4.50%	4.90%
Expected volatility		17%	17%

Total pre-tax compensation cost recognized for stock options during the years ended December 31, 2008, 2007, and 2006, was $2.6 million, $1.8 million, and $1.8 million, respectively. The total compensation cost capitalized in 2008, 2007, and 2006 was not significant. As of December 31, 2008, $1.7 million of total pre-tax compensation cost related to unvested and outstanding stock options was expected to be recognized over a weighted-average period of 2.6 years.

Cash received from option exercises during the years ended December 31, 2008, 2007, and 2006, was $3.3 million, $14.0 million, and $1.9 million, respectively. The tax benefit realized from these option exercises was not significant in 2008, $2.3 million in 2007, and not significant in 2006.

A summary of stock option activity for the year ended December 31, 2008, and the number of outstanding and exercisable stock options at December 31, 2008, is presented below:

	Stock Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life *(in Years)*	Aggregate Intrinsic Value *(Millions)*
Outstanding at December 31, 2007	2,215,999	$47.81		
Granted	**684,404**	**48.36**		
Exercised	**75,142**	**43.46**		**$0.2**
Forfeited	**125,122**	**51.37**		**–**
Outstanding at December 31, 2008	[illegible]	**$47.90**	**6.46**	**$3.1**
Exercisable at December 31, 2008	[illegible]	[illegible]	[illegible]	[illegible]

During the years ended December 31, 2007 and 2006, the intrinsic value of options exercised totaled $4.4 million and $0.9 million, respectively.

The aggregate intrinsic value for outstanding and exercisable options in the above table represents the total pre-tax intrinsic value that would have been received by the option holders had they all exercised their options at December 31, 2008. This is calculated as the difference between Integrys Energy Group's closing stock price on December 31, 2008, and the option exercise price, multiplied by the number of in-the-money stock options.

Performance Stock Rights

Performance stock rights vest over a three-year performance period and are paid out in shares of Integrys Energy Group's common stock. No single employee who is the chief executive officer of Integrys Energy Group or any of the other four highest compensated officers of Integrys Energy Group and its subsidiaries can receive a payout in excess of 250,000 performance shares during any calendar year. The number of shares paid out is calculated by multiplying a performance percentage by the number of outstanding stock rights at the completion of the vesting period. The performance percentage is based on the total shareholder return of Integrys Energy Group's common stock relative to the total shareholder return of a peer group of companies. The payout may range from 0% to 200% of target.

The fair values of performance stock rights granted were estimated using a Monte Carlo valuation model, incorporating the assumptions in the table below. The risk-free interest rate is based on the United States Treasury yield curve. The expected dividend yield incorporates the dividend rate at the measurement date. The expected volatility was estimated using three years of historical data.

	2008	2007	2006
Expected term		3 years	3 years
Risk-free interest rate		4.71%	4.74%
Expected dividend yield		4.50%	4.90%
Expected volatility		14.5%	14.4%

Pre-tax compensation cost recorded for performance stock rights for the years ended December 31, 2008, 2007, and 2006 was $5.2 million, $3.5 million, and $2.8 million, respectively. The total compensation cost capitalized during these same years was not significant. As of December 31, 2008, $2.4 million of total pre-tax compensation cost related to unvested and outstanding performance stock rights was expected to be recognized over a weighted-average period of 1.8 years.

A summary of the activity related to performance stock rights for the year ended December 31, 2008, is presented below:

	Performance Stock Rights	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2007	217,458	$48.72
Granted	**125,600**	**49.22**
Expired	**54,207**	**41.62**
Forfeited	**25,742**	**51.67**
Outstanding at December 31, 2008	[illegible]	[illegible]

No performance shares were distributed during the year ended December 31, 2008, as a result of the performance percentage being below the target payout level for those rights that were vested and eligible to be distributed in 2008.

Restricted Shares and Restricted Share Units

In 2008, 2007, and 2006, a portion of the long-term incentive was awarded in the form of restricted shares and restricted share units. Most of these awards have a four-year vesting period, with 25% of each award vesting on each anniversary of the grant date. During the vesting period, restricted share recipients have voting rights and are entitled to dividends in the same manner as other common shareholders, whereas restricted share unit recipients receive dividend credits and do not have voting rights. Restricted shares and restricted share units have a value equal to the fair market value of the shares on the grant date. Total pre-tax compensation cost recognized for these awards was $4.2 million and $1.4 million during the years ended December 31, 2008, and 2007, respectively, and was not significant for the year ended December 31, 2006. The total compensation cost capitalized in 2008, 2007, and 2006 was not significant. As of December 31, 2008, $6.2 million of total pre-tax compensation cost related to these awards was expected to be recognized over a weighted-average period of 2.7 years.

A summary of the activity related to restricted share and restricted share unit awards for the year ended December 31, 2008, is presented below:

	Restricted Shares and Restricted Share Units	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2007	101,145	$54.70
Granted	**172,815**	**48.36**
Vested	[illegible]	[illegible]
Forfeited	[illegible]	[illegible]
Outstanding at December 31, 2008	[illegible]	[illegible]

Stock Appreciation Rights

On February 21, 2007, all of PEC's then outstanding stock appreciation rights were converted into 14,021 Integrys Energy Group stock appreciation rights. The fair value of the stock appreciation rights is estimated with a Black-Scholes model and was not significant at December 31, 2008. No stock appreciation rights were issued during the year ended December 31, 2008.

NOTE 21—FAIR VALUE

Fair Value Measurements

The following table shows Integrys Energy Group's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008, categorized by level within the fair value hierarchy.

(Millions)	Level 1	Level 2	Level 3	Total
Assets				
Risk management assets	**$703.0**	**$1,520.7**	**$755.4**	**$2,979.1**
Inventory hedged by fair value hedges	**–**	**27.4**	**–**	**27.4**
Other	**0.5**	**–**	**–**	**0.5**
Liabilities				
Risk management liabilities	**820.5**	**1,557.2**	**573.4**	**2,951.1**
Long-term debt hedged by fair value hedge	[illegible]	[illegible]	[illegible]	[illegible]

The determination of the fair values above incorporates various factors required under SFAS No. 157. These factors include not only the credit standing of the counterparties involved, but also the impact of Integrys Energy Group's nonperformance risk on its liabilities.

The risk management assets and liabilities listed in the table include options, swaps, futures, physical commodity contracts, and other instruments used to manage market risks related to changes in commodity prices and interest rates. For more information on Integrys Energy Group's derivative instruments, see Note 2, *"Risk Management Activities."*

When possible, Integrys Energy Group bases the valuations of its risk management assets and liabilities on quoted prices for identical assets in active markets. These valuations are classified in Level 1. The valuations of certain contracts are based on NYMEX futures prices with an adjustment related to location differences, and certain derivative instruments are valued using broker quotes or prices for similar contracts at the reporting date. These valuations are classified in Level 2.

Certain derivatives are categorized in Level 3 due to the significance of unobservable or internally developed inputs. The primary reasons for a Level 3 classification are as follows:

- While price curves may have been based on observable information, significant assumptions may have been made regarding seasonal or monthly shaping and locational basis differentials.

- Certain transactions were valued using price curves that extended beyond the quoted period. Assumptions were made to extrapolate prices from the last quoted period through the end of the transaction term.

- The valuations of certain transactions were based on internal models, although external inputs were utilized in the valuation.

The following table sets forth a reconciliation of changes in the fair value of items categorized as Level 3 measurements:

(Millions)	[illegible]
Balance at the beginning of period	[illegible]
Net realized and unrealized loss included in earnings	[illegible]
Net unrealized loss recorded as regulatory assets or liabilities	[illegible]
Net unrealized loss included in other comprehensive income (loss)	[illegible]
Net purchases and settlements	[illegible]
Net transfers in/out of Level 3	[illegible]
Balance at December 31, 2008	[illegible]
Net unrealized loss included in earnings related to instruments still held at December 31, 2008	[illegible]

Derivatives are transferred in or out of Level 3 primarily due to changes in the source of data used to construct price curves as a result of changes in market liquidity.

Unrealized gains and losses included in earnings related to Integrys Energy Services' risk management assets and liabilities are recorded through nonregulated revenue on the Consolidated Statements of Income (Loss). Realized gains and losses on these same instruments are recorded in nonregulated revenue or nonregulated cost of fuel, natural gas, and purchased power, depending on the nature of the instrument. Unrealized gains and losses on Level 3 derivatives at the utilities are deferred as regulatory assets or liabilities, pursuant to SFAS No. 71. Therefore, these fair value measurements have no impact on earnings. Realized gains and losses on these instruments flow through utility cost of fuel, natural gas, and purchased power.

Fair Value of Financial Instruments

The following table shows the financial instruments included on the Consolidated Balance Sheets of Integrys Energy Group that are not recorded at fair value.

	2008		2007	
(Millions)	[illegible]	[illegible]	Carrying Amount	Fair Value
Long-term debt	[illegible]	[illegible]	$2,320.3	$2,334.2
Preferred stock	[illegible]	[illegible]	51.1	49.6

The fair values of long-term debt and preferred stock are estimated based on the quoted market price for the same or similar issues or on the current rates offered to Integrys Energy Group for debt of the same remaining maturity.

Due to the short maturity of cash and cash equivalents, accounts receivable, accounts payable, notes payable, and outstanding commercial paper, the carrying amount approximates fair value.

NOTE 22—MISCELLANEOUS INCOME

Integrys Energy Group's total miscellaneous income was as follows at December 31:

(Millions)	[illegible]	2007	2006
Equity earnings on investments	[illegible]	$34.6	$19.9
Interest and dividend income	[illegible]	12.7	9.5
Weston 4 ATC interconnection agreement interest	[illegible]	3.9	1.0
Equity AFUDC	[illegible]	0.9	0.6
Gain (loss) on sale of property	[illegible]	1.9	(0.3)
(Loss) gain on investments	[illegible]	3.9	11.7
Gain (loss) on foreign currency exchange	[illegible]	2.4	(1.5)
Key executive life insurance income	[illegible]	2.2	2.1
Other	[illegible]	1.6	(0.2)
Total miscellaneous income	[illegible]	$64.1	$42.8

NOTE 23—REGULATORY ENVIRONMENT

Wisconsin

<u>2009 Rate Case</u>

On December 30, 2008, the PSCW issued a final written order for WPS authorizing no annual rate increase for retail electric rates as compared with the fuel surcharge adjusted rates authorized on July 4, 2008, or a $48.0 million increase for retail electric rates as compared with the rates authorized on January 16, 2008. The PSCW required a $3.0 million decrease in retail natural gas rates.

On September 2, 2008, WPS and the Citizens Utility Board filed an agreement to implement a decoupling mechanism as a four-year pilot program, which would allow WPS to adjust rates to recover or refund the difference between the actual and authorized margin impacts of variations in volumes. The PSCW approved this decoupling mechanism, with certain conditions, in the December 30, 2008, final order discussed above. The decoupling conditions included an annual $12.0 million cap for electric service and an annual $4.0 million cap for natural gas service. On January 16, 2009, WPS requested rehearing to remove or increase the decoupling caps. On February 24, 2009, in a written order, the PSCW increased the caps to $14.0 million for electric service and $8.0 million for natural gas service.

2008 Rate Case

On January 15, 2008, the PSCW issued a final written order for WPS authorizing a retail electric rate increase of $23.0 million (2.5%), which included recovery of deferred 2005 and 2006 MISO Day 2 costs over a one-year period and increased electric transmission costs. The new rates became effective January 16, 2008. On February 11, 2008, WPS filed an application with the PSCW to adjust its 2008 rates for increased fuel and purchased power costs. The application requested an increase in retail electric rates due to a delay in the in-service date of the Weston 4 power plant, increased coal and coal transportation costs, and increased natural gas costs. The PSCW approved an interim annual fuel surcharge increase of $29.7 million on March 20, 2008, and an additional final fuel surcharge increase of $18.3 million, effective July 4, 2008.

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 the lower fuel and purchased power costs, WPS's rates were subject to refund, from September 30, 2008, through December 31, 2008. On February 9, 2009, WPS filed a request with the PSCW to refund approximately $5 million of 2008 fuel costs to Wisconsin electric retail customers. This refund was accrued at December 31, 2008, and is subject to review by the PSCW.

2007 Rate Case

On January 11, 2007, the PSCW issued a final written order for WPS authorizing a retail electric rate increase of $56.7 million (6.6%) and a retail natural gas rate increase of $18.9 million (3.8%), effective January 12, 2007. The new rates reflect a 10.9% return on common equity. The PSCW approved a common equity ratio of 57.4% in WPS's regulatory capital structure. The 2007 retail electric rate increase was required primarily because of increased costs associated with electric transmission, costs related to the construction of Weston 4 and the additional personnel to maintain and operate the plant, and costs to maintain the Weston 3 generation unit and the De Pere Energy Center. The 2007 retail natural gas rate increase was driven by infrastructure improvements necessary to ensure the reliability of the natural gas distribution system and costs associated with the remediation of former manufactured gas plant sites.

2006 Rate Case

On December 22, 2005, the PSCW issued a final written order authorizing a retail electric rate increase of $79.9 million (10.1%) and a retail natural gas increase of $7.2 million (1.1%), effective January 1, 2006. The 2006 rates reflect an 11.0% return on common equity. The PSCW also approved a common equity ratio of 59.7% in its regulatory capital structure. The 2006 retail electric rate increase was required primarily because of higher fuel and purchased power costs (including costs associated with the Fox Energy Center power purchase agreement), and also for costs related to the construction of Weston 4, higher transmission expenses, and recovery of a portion of the costs related to the 2005 Kewaunee outage. Partially offsetting the items discussed above, retail electric rates were lowered to reflect a refund to customers of the proceeds received from the liquidation of the nonqualified decommissioning trust fund as a result of the sale of Kewaunee (discussed below). The 2006 retail natural gas rate increase was driven by infrastructure improvements necessary to ensure the reliability of the natural gas distribution system.

Weston 3 Outage

On October 6, 2007, Weston 3, a coal-fired generating facility located near Wausau, Wisconsin, sustained damage from a major lightning strike that forced the facility out of service until January 14, 2008. The damage required the repair of the generator rotor, turbine rotors, and boiler feed pumps. WPS incurred $8.9 million of incremental pre-tax non-fuel operating and maintenance expenditures through January 14, 2008, to repair and return Weston 3 to service. WPS has insurance in place that covered all non-fuel operating and maintenance expenditures, less a $1.0 million deductible. WPS incurred a total of $26.6 million of incremental pre-tax fuel and purchased power costs during the 14-week outage. WPS was granted approval from the PSCW to defer the replacement fuel and purchased power costs for the Wisconsin retail portion of these costs retroactive to the date of the lightning strike. On December 30, 2008, the PSCW granted WPS recovery of $17.0 million of the requested $19.6 million of Weston 3 replacement fuel and power costs from the Wisconsin retail jurisdiction, over a six-year period and without carrying costs.

It is anticipated that WPS will recover a similar portion of replacement purchased power costs from the Michigan retail jurisdiction through the annual power supply cost recovery mechanism.

PEC Merger

The PSCW approved the merger with PEC as of February 16, 2007. The merger approval order contains the following conditions:

- WPS will not have a base rate increase for natural gas or electric service prior to January 1, 2009. 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 the NYMEX natural gas futures prices, coal prices, and transportation costs for coal.

- WPS was required to seek approval for the formation of a service company within 120 days of the closing of the merger. All required regulatory approvals were received and Integrys Business Support, LLC (IBS) became operational on January 1, 2008.

- WPS will not recover merger related transaction costs. Recovery of merger related transition costs in 2009 and later years will be limited to the verified synergy savings in those years.

- WPS will hold ratepayers harmless from any increase in interest and preferred stock costs attributable to nonutility activities, provided that the authorized capital structure is consistent with the authorized costs.

- WPS will not pay dividends to Integrys Energy Group in an amount greater than 103% of the prior year's dividend.

Kewaunee

WPS received $127.1 million of proceeds from the liquidation of the Kewaunee nonqualified decommissioning trust fund in 2005, which was refunded to customers in the following manner:

- The PSCW ruled that WPS's Wisconsin customers were entitled to be refunded approximately 85% of the proceeds over a two-year period beginning on January 1, 2006.

- The MPSC ruled that WPS's Michigan customers were entitled to be refunded approximately 2% of the proceeds over a 60-month period, beginning in the third quarter of 2005. Subsequently, the MPSC issued an order authorizing WPS to amortize the approximately $2 million remaining balance of the refund simultaneously with the amortization of approximately $2 million of the 2005 power supply under collections from January 2007 through July 2010.

- The FERC ruled that WPS's wholesale customers were entitled to be refunded the remaining 13% of the proceeds. A refund of approximately $3 million was made to one customer in the second quarter of 2006, which was offset by approximately $1 million related to both the loss WPS recorded on the sale of Kewaunee and costs incurred related to the 2005 Kewaunee outage. Pursuant to the FERC order settlement received on August 14, 2007, WPS completed lump sum payments to the remaining FERC customers of approximately $16 million (including interest), representing their contributions to the nonqualified decommissioning trust fund during the period in which they received service from WPS. The settlement would also require these FERC customers to make two separate lump-sum payments to WPS with respect to the loss from the sale of Kewaunee and the 2005 Kewaunee power outage. Payments made to WPS total approximately $1 million and $8 million, respectively, and were netted against the $16 million refund due to these customers.

The PSCW disallowed recovery of 50% of the 2005 loss on the sale of Kewaunee. The entire loss had previously been approved for deferral, resulting in WPS writing off $6.1 million in 2005 of the regulatory asset previously recorded.

On February 20, 2005, Kewaunee was temporarily removed from service after a potential design weakness was identified in its auxiliary feedwater system. In WPS's 2006 rate case, the PSCW determined that it was reasonable for WPS to recover all deferred costs related to the 2005 Kewaunee forced outage over a five-year period, beginning on January 1, 2006. At December 31, 2008, $19.1 million was left to be collected from ratepayers and remained recorded as a regulatory asset related to this outage.

Michigan

2009 MGU Rate Case
On January 13, 2009, the MPSC issued a final written order approving a settlement agreement authorizing a retail natural gas rate increase of $6.0 million, effective January 14, 2009. The rate increase was required due primarily to general inflation, low margin revenue growth, increased costs of customer service functions, and increased costs to environmentally remediate former manufactured gas plants.

2008 WPS Rate Case
On December 4, 2007, the MPSC issued a final written order authorizing WPS a retail electric rate increase of $0.6 million, effective December 5, 2007. WPS's last retail electric rate increase in Michigan was in July 2003. The new rates reflect a 10.6% return on common equity. The MPSC approved a common equity ratio of 56.4% in WPS's regulatory capital structure.

Illinois

2010 Rate Case
On February 25, 2009, PGL and NSG each filed a request with the ICC to increase natural gas distribution rates for 2010. PGL's requested increase is $161.9 million and NSG's requested increase is $22.0 million. The proposed rate increase is required to allow PGL and NSG to recover their forecasted 2010 cost of service and to earn a reasonable return on their investment. Each filing includes a proposed 12% rate of return on common equity and a common equity ratio of 56% in its regulatory capital structure. The filing includes a proposed overall return of 9.34% and 9.18% for PGL and NSG, respectively. PGL also requested approval of a mechanism for cost recovery, outside of the rate case, of an accelerated cast iron main replacement program.

The Illinois rate case process requires receipt of a written order from the ICC within 11 months from the filing date, which would be January 2010.

2008 Rate Case
On February 5, 2008, the ICC issued a final written order authorizing PGL a retail natural gas distribution rate increase of $71.2 million and requiring a retail natural gas rate decrease of $0.2 million for NSG. The new rates for PGL reflected a 10.19% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The new rates for NSG reflected a 9.99% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The order included approval of a Volume Balancing Adjustment (VBA) decoupling mechanism, effective March 1, 2008, as a four-year pilot program, which will allow PGL and NSG to adjust rates going forward to recover or refund the difference between the actual and authorized margin impact of variations in volumes. Legislation was introduced at the Illinois state legislature to roll back decoupling but never reached a vote. This legislation may be introduced again. Integrys Energy Group actively supports the ICC's decision to approve this rate setting mechanism. The order also approved an Enhanced Efficiency Program, which will allow PGL and NSG to recover $6.4 million and $1.1 million, respectively, of energy efficiency costs. PGL and NSG filed tariffs in compliance with the order on February 8, 2008, and the new rates became effective February 14, 2008.

On March 26, 2008, the ICC denied PGL's and NSG's request for rehearing of their rate orders, and all but one such request from interveners. The ICC only granted rehearing on a request to change the way PGL allocates interstate hub services revenues among customer groups. On April 28, 2008, PGL and NSG filed a Notice of Appeal with the Illinois appellate court regarding the ICC's order denying rehearing on certain issues. On April 30, 2008, the ICC submitted a letter to the Illinois appellate court stating that rehearing is pending before the ICC and, while the ICC would not file to dismiss the PGL and NSG appeal as premature, it requested that the court hold the due date for the ICC to file the record with the court. On May 2, 2008, two interveners each separately filed a Notice of Appeal. On June 6, 2008, several parties filed a stipulation to resolve the way PGL allocates interstate hub services revenues among customer groups. On July 30, 2008, the ICC approved the stipulation, as well as a rehearing order. The approved stipulation took effect on November 1, 2008. Subsequent to the approval of the stipulation, PGL and NSG filed appeals in the second district of the Illinois appellate court and after that, four other parties filed appeals in the first district of the Illinois appellate court. On September 29, 2008, the ICC asked the Illinois Supreme Court to vacate the second district's transfer of the appeal to the first district, and the Illinois Supreme Court denied the ICC's motion. On appeal, parties may only raise issues on which they sought rehearing at the ICC. These issues include the VBA decoupling mechanism. No decision on the appeal is expected until at least the second half of 2009.

PEC Merger
The PEC merger was effective February 21, 2007. PGL and NSG are wholly owned by PEC. On February 7, 2007, the ICC approved the PEC merger by accepting an agreed upon order among the active parties to the merger case. The order included Conditions of Approval regarding commitments by the applicants to:

- provide certain reports,
- perform studies of the PGL natural gas system,
- promote and hire a limited number of union employees in specific areas,
- make no reorganization-related layoffs or position reductions within the PGL union workforce,
- maintain both the PGL and NSG operation and maintenance and capital budgets at recent levels,
- file a plan for formation and implementation of a service company,
- accept certain limits on the merger-related costs that can be recovered from ratepayers, and

- not seek cost recovery for any increase in deferred tax assets that may result from the tax treatment of the PGL and NSG natural gas storage inventory in connection with closing the merger.

The Conditions of Approval also included the following commitments with respect to the recently completed rate cases of PGL and NSG:

- inclusion of merger synergy savings of $11.4 million at PGL and $1.6 million at NSG in the proposed test year,

- recovery of $6.2 million at PGL and $0.8 million at NSG of the merger-related costs in the test year (reflecting recovery of $30.9 million of costs at PGL and $4.2 million of costs at NSG over 5 years),

- proposing a combined $7.5 million Enhanced Efficiency Program at PGL and NSG, which was contingent on receiving cost recovery in the rate case orders, and

- filing certain changes to the small volume transportation service programs.

The ICC approved a cost recovery mechanism for the Enhanced Efficiency Program costs. The order provides authority for PGL and NSG to recover from ratepayers up to an additional $9.9 million of combined merger costs in a future rate case, for a maximum potential recovery of $44.9 million. PGL and NSG must demonstrate in the future that the merger synergy savings realized have exceeded merger costs. As of December 31, 2008, the regulatory asset balance representing merger costs to be recovered totaled $10.7 million at PGL and $1.5 million at NSG.

Minnesota

On July 31, 2008, MERC filed a request with the Minnesota Public Utility Commission (MPUC) to increase retail natural gas rates $22.0 million (6.4%). The proposed natural gas rate increase is required because of general inflation coupled with low sales growth and increased costs to provide customer service functions. On September 11, 2008, the MPUC issued an order approving an interim rate increase of $19.8 million, effective October 1, 2008. This interim rate increase is subject to refund pending the final rate order, which is expected in the second quarter of 2009.

Federal

Through a series of orders issued by the FERC, Regional Through and Out Rates for transmission service between MISO and the PJM Interconnection were eliminated effective December 1, 2004. To compensate transmission owners for the revenue they will no longer receive due to this rate elimination, the FERC ordered a transitional pricing mechanism called the Seams Elimination Charge Adjustment (SECA) be put into place. Load-serving entities paid these SECA charges during a 16-month transition period from December 1, 2004, through March 31, 2006.

For the 16-month transitional period, Integrys Energy Services received billings of $19.2 million (pre-tax) for these charges. Integrys Energy Services expensed $14.7 million of the $19.2 million, as it is probable that Integrys Energy Services' total exposure will be reduced by at least $4.5 million due to inconsistencies between the FERC's SECA order and the transmission owners' compliance filings. Integrys Energy Services has reached settlement agreements with three of its vendors for a combined $1.6 million.

In August 2006, the administrative law judge hearing the case issued an Initial Decision that was in agreement with all of Integrys Energy Services' positions. If the Final Order is consistent with the Initial Decision of the administrative law judge, Integrys Energy Services' pre-tax exposure of $19.2 million may be reduced by as much as $13 million. The Final FERC Order is subject to rehearing and then court challenges. Any refunds to Integrys Energy Services will include interest for the period from payment to refund.

The SECA is also an issue for WPS and UPPCO. It is anticipated that most of the SECA charges incurred or refunds received by WPS and UPPCO will be passed on to customers through rates, and will not have a material effect on the financial position or results of operations of WPS or UPPCO.

NOTE 24—SEGMENTS OF BUSINESS

SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," requires that companies disclose segment information based on how management makes decisions about allocating resources to segments and measuring their performance.

Integrys Energy Group manages its reportable segments separately due to their different operating and regulatory environments. At December 31, 2008, Integrys Energy Group reported four segments, which are described below.

- The electric utility segment includes the regulated electric utility operations of WPS and UPPCO.

- The natural gas utility segment includes the regulated natural gas utility operations of WPS, MGU, MERC, PGL, and NSG. The regulated natural gas utility operations of PGL and NSG have been included in results of operations since the PEC merger date.

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

- The Holding Company and Other segment, another nonregulated segment, includes the operations of the Integrys Energy Group holding company and the PEC holding company (which was included in results of operations since the PEC merger date), along with any nonutility activities at WPS, MGU, MERC, UPPCO, PGL, NSG, and IBS. IBS is a wholly owned centralized service company that provides administrative and general support services for Integrys Energy Group's six regulated utilities and portions of administrative and general support services for Integrys Energy Services. Equity earnings from our investments in ATC and WRPC are also included in the Holding Company and Other segment.

The nonregulated oil and natural gas production segment includes the results of PEP, which were reported as discontinued operations in 2007. PEP engaged in the acquisition, development, and production of oil and natural gas reserves in selected onshore basins in the United States through direct ownership in oil, natural gas, and mineral leases. Integrys Energy Group completed the sale of PEP in September 2007.

The tables below present information for the respective years pertaining to our operations segmented by lines of business.

2008 *(Millions)*	Regulated Utilities: Electric Utility [1]	Regulated Utilities: Natural Gas Utility [1]	Regulated Utilities: Total Utility [1]	Nonutility and Nonregulated Operations: Integrys Energy Services	Nonutility and Nonregulated Operations: Holding Company and Other [2]	Reconciling Eliminations	Integrys Energy Group Consolidated
Income Statement							
External revenues	**$1,284.6**	**$3,025.3**	**$4,309.9**	**$9,726.5**	**$ 11.4**	**$ –**	**$14,047.8**
Intersegment revenues	**44.3**	**0.6**	**44.9**	**8.7**	**0.6**	**(54.2)**	**–**
Goodwill impairment loss	**–**	**6.5**	**6.5**	**–**	**–**	**–**	**6.5**
Depreciation and amortization expense	**84.3**	**108.3**	**192.6**	**14.5**	**14.3**	**–**	**221.4**
Miscellaneous income (expense)	**6.0**	**7.0**	**13.0**	**8.7**	**111.5**	**(45.9)**	**87.3**
Interest expense	**36.7**	**56.6**	**93.3**	**12.1**	**98.6**	**(45.9)**	**158.1**
Provision (benefit) for income taxes	**48.1**	**57.1**	**105.2**	**(56.2)**	**2.2**	**–**	**51.2**
Income (loss) from continuing operations	**94.7**	**85.5**	**180.2**	**(65.4)**	**10.0**	**–**	**124.8**
Discontinued operations	**–**	**–**	**–**	**3.9**	**0.8**	**–**	**4.7**
Preferred stock dividends of subsidiary	**2.1**	**1.0**	**3.1**	**–**	**–**	**–**	**3.1**
Income (loss) available for common shareholders	**92.6**	**84.5**	**177.1**	**(61.5)**	**10.8**	**–**	**126.4**
Total assets	**2,752.4**	**5,173.8**	**7,926.2**	**5,050.2**	**2,491.2**	**(1,195.1)**	**14,272.5**
Cash expenditures for long-lived assets	[illegible]	[illegible]	**444.7**	**68.1**	**20.0**	**–**	**532.8**

[1] *Includes only utility operations.*
[2] *Nonutility operations are included in the Holding Company and Other column.*

2007 *(Millions)*	Regulated Utilities: Electric Utility [1]	Regulated Utilities: Natural Gas Utility [1]	Regulated Utilities: Total Utility [1]	Nonutility and Nonregulated Operations: Integrys Energy Services	Nonutility and Nonregulated Operations: Oil and Natural Gas Production	Nonutility and Nonregulated Operations: Holding Company and Other [2]	Reconciling Eliminations	Integrys Energy Group Consolidated
Income Statement								
External revenues	$1,202.9	$2,102.5	$3,305.4	$6,975.7	$ –	$ 11.3	$ –	$10,292.4
Intersegment revenues	43.2	1.2	44.4	4.0	–	1.2	(49.6)	–
Depreciation and amortization expense	80.1	97.7	177.8	14.4	–	2.9	–	195.1
Miscellaneous income (expense)	8.3	5.5	13.8	(0.3)	0.1	81.4	(30.9)	64.1
Interest expense	32.4	53.4	85.8	13.5	2.4	93.7	(30.9)	164.5
Provision (benefit) for income taxes	51.5	14.5	66.0	26.3	(1.0)	(5.3)	–	86.0
Income (loss) from continuing operations	89.6	29.6	119.2	83.2	(2.5)	(18.8)	–	181.1
Discontinued operations	–	–	–	14.8	58.5	–	–	73.3
Preferred stock dividends of subsidiary	2.2	0.9	3.1	–	–	–	–	3.1
Income (loss) available for common shareholders	87.4	28.7	116.1	98.0	56.0	(18.8)	–	251.3
Total assets	2,470.8	4,777.8	7,248.6	3,150.6	–	1,911.4	(1,076.2)	11,234.4
Cash expenditures for long-lived assets	202.6	158.8	361.4	20.5	–	10.7	–	392.6

[1] *Includes only utility operations.*
[2] *Nonutility operations are included in the Holding Company and Other column.*

2006 (Millions)	Regulated Utilities			Nonutility and Nonregulated Operations			
	Electric Utility [1]	Natural Gas Utility [1]	Total Utility [1]	Integrys Energy Services	Holding Company and Other [2]	Reconciling Eliminations	Integrys Energy Group Consolidated
Income Statement							
External revenues	$1,057.9	$676.1	$1,734.0	$5,151.8	$ 4.9	$ –	$6,890.7
Intersegment revenues	41.5	0.8	42.3	7.3	1.2	(50.8)	–
Depreciation and amortization expense	78.5	32.7	111.2	9.4	0.7	–	121.3
Miscellaneous income (expense)	3.2	1.0	4.2	(11.4)	66.0	(16.0)	42.8
Interest expense	30.0	18.1	48.1	15.4	51.7	(16.0)	99.2
Provision (benefit) for income taxes	48.6	1.5	50.1	(5.0)	(0.1)	–	45.0
Income (loss) from continuing operations	87.6	(1.3)	86.3	65.0	0.3	–	151.6
Discontinued operations	–	–	–	7.3	–	–	7.3
Preferred stock dividends of subsidiary	2.1	1.0	3.1	–	–	–	3.1
Income (loss) available for common shareholders	85.5	(2.3)	83.2	72.3	0.3	–	155.8
Cash expenditures for long-lived assets	282.1	54.6	336.7	5.5	(0.2)	–	342.0

[1] Includes only utility operations.
[2] Nonutility operations are included in the Holding Company and Other column.

Geographic Information (Millions)	2008		2007		2006
	Revenues	Long-Lived Assets	Revenues	Long-Lived Assets	Revenues
United States	[illegible]	[illegible]	$ 8,343.8	$7,028.2	$4,908.6
Canada *	[illegible]	[illegible]	1,948.6	20.6	1,982.1
Total	[illegible]	[illegible]	$10,292.4	$7,048.8	$6,890.7

* Revenues and assets of Canadian subsidiaries.

NOTE 25—QUARTERLY FINANCIAL INFORMATION (Unaudited)

	Three Months Ended 2008				
(Millions, except share amounts)	**March**	**June**	**September**	**December**	**Total**
Operating revenues	**$3,989.2**	**$3,417.2**	**$3,223.1**	**$3,418.3**	**$14,047.8**
Operating income (loss)	**234.7**	**53.1**	**(76.2)**	**35.1**	**246.7**
Income (loss) from continuing operations	**136.6**	**24.8**	**(58.4)**	**21.8**	**124.8**
Discontinued operations, net of tax	**–**	**0.1**	**–**	**4.6**	**4.7**
Preferred stock dividends of subsidiary	**0.8**	**0.8**	**0.7**	**0.8**	**3.1**
Income (loss) available for common shareholders	**$ 135.8**	**$ 24.1**	**$ (59.1)**	**$ 25.6**	**$ 126.4**
Average number of shares of common stock (basic)	**76.6**	**76.6**	**76.7**	**76.7**	**76.7**
Average number of shares of common stock (diluted)	**76.8**	**76.9**	**76.7**	**77.0**	**77.0**
Earnings (loss) per common share (basic) *					
Income (loss) from continuing operations	**$1.77**	**$0.31**	**$(0.77)**	**$0.27**	**$1.59**
Discontinued operations	**–**	**–**	**–**	**0.06**	**0.06**
Earnings (loss) per common share (basic)	**1.77**	**0.31**	**(0.77)**	**0.33**	**1.65**
Earnings (loss) per common share (diluted) *					
Income (loss) from continuing operations	**1.77**	**0.31**	**(0.77)**	**0.27**	**1.58**
Discontinued operations	**–**	**–**	**–**	**0.06**	**0.06**
Earnings (loss) per common share (diluted)	**1.77**	**0.31**	**(0.77)**	**0.33**	**1.64**

** Earnings per share for the individual quarters do not total the year ended earnings per share amount because of changes to the average number of shares outstanding and changes in incremental issuable shares throughout the year.*

	Three Months Ended 2007				
(Millions, except share amounts)	March	June	September	December	Total
Operating revenues	$2,746.6	$2,361.7	$2,122.5	$3,061.6	$10,292.4
Operating income (loss)	183.1	(33.9)	54.1	164.1	367.4
Income (loss) from continuing operations	117.2	(39.6)	11.6	91.9	181.1
Discontinued operations, net of tax	23.0	24.0	32.3	(6.0)	73.3
Preferred stock dividends of subsidiary	0.8	0.8	0.7	0.8	3.1
Income (loss) available for common shareholders	$ 139.4	$ (16.4)	$ 43.2	$ 85.1	$ 251.3
Average number of shares of common stock (basic)	57.5	76.0	76.2	76.5	71.6
Average number of shares of common stock (diluted)	57.8	76.0	76.5	76.6	71.8
Earnings (loss) per common share (basic) *					
Income (loss) from continuing operations	$2.02	$(0.53)	$0.14	$1.19	$2.49
Discontinued operations	0.40	0.31	0.43	(0.08)	1.02
Earnings (loss) per common share (basic)	2.42	(0.22)	0.57	1.11	3.51
Earnings (loss) per common share (diluted) *					
Income (loss) from continuing operations	2.01	(0.53)	0.14	1.19	2.48
Discontinued operations	0.40	0.31	0.42	(0.08)	1.02
Earnings (loss) per common share (diluted)	2.41	(0.22)	0.56	1.11	3.50

** Earnings per share for the individual quarters do not total the year ended earnings per share amount because of changes to the average number of shares outstanding and changes in incremental issuable shares throughout the year.*

Because of various factors, the quarterly results of operations are not necessarily comparable.

Deloitte.

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

We have audited the accompanying consolidated balance sheets of Integrys Energy Group, Inc. and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of income, common shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Integrys Energy Group, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1(t) to the consolidated financial statements, at January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, "Fair Value Measurements."

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2009, expressed an unqualified opinion on the Company's internal control over financial reporting.

Deloitte & Touche LLP

Milwaukee, WI
February 25, 2009

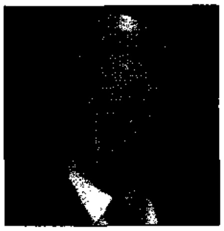
FINANCIAL AND OTHER STATISTICS

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)***	**2008**	**2007 (1)**	**2006 (2)**	**2005**	**2004**
Total revenues	**$14,047.8**	$10,292.4	$6,890.7	$6,825.5	$4,876.1
Income from continuing operations	**124.3**	181.1	151.6	150.6	156.6
Income available for common shareholders	**126.4**	251.3	155.8	157.4	139.7
Total assets	**14,272.5**	11,234.4	6,861.7	5,462.5	4,376.8
Preferred stock of subsidiaries	**51.1**	51.1	51.1	51.1	51.1
Long-term debt (excluding current portion)	**2,288.0**	2,265.1	1,287.2	867.1	865.7
Shares of common stock (*less treasury stock and shares in deferred compensation trust*)					
Outstanding	**76.0**	76.0	43.1	39.8	37.3
Average	**76.7**	71.6	42.3	38.3	37.4
Earnings per common share (basic)					
Income from continuing operations	**$1.59**	$2.49	$3.51	$3.85	$4.10
Earnings per common share	**1.65**	3.51	3.68	4.11	3.74
Earnings per common share (diluted)					
Income from continuing operations	**1.58**	2.48	3.50	3.81	4.08
Earnings per common share	**1.64**	3.50	3.67	4.07	3.72
Dividend per share of common stock	**2.68**	2.56	2.28	2.24	2.20
Stock price at year-end	**$42.98**	$51.69	$54.03	$55.31	$49.96
Book value per share	**$40.78**	$42.58	$35.61	$32.76	$29.30
Return on average equity	**3.7%**	8.5%	10.6%	13.6%	13.5%
Number of common stock shareholders	**34,016**	35,212	19,837	20,701	21,358
Number of employees	[illegible]	5,231	3,326	2,945	3,048

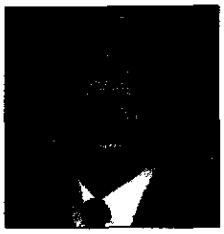
(1) Includes the impact of the Peoples Energy Corporation merger on February 21, 2007.

(2) Includes the impact of the acquisition of natural gas distribution operations from Aquila by Michigan Gas Utilities Corporation on April 1, 2006, and Minnesota Energy Resources Corporation on July 1, 2006.

BOARD OF DIRECTORS *

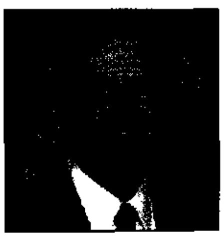


Keith E. Bailey
Age 66 ■ Tulsa, Oklahoma
Former Chairman and Chief Executive Officer –
The Williams Companies, Inc.
(Director since 2005)
Audit Committee
Financial Committee

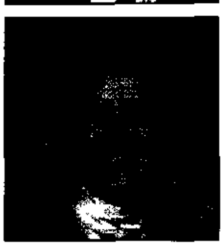


Richard A. Bemis
Age 67 ■ Sheboygan, Wisconsin
Co-chairman of the Board of Directors –
Bemis Manufacturing Company
(Director since 1983)
Compensation Committee
Governance Committee

William J. Brodsky
Age 64 ■ Chicago, Illinois
Chairman and Chief Executive Officer –
The Chicago Board Options Exchange
(Director since 1997)
Compensation Committee
Financial Committee



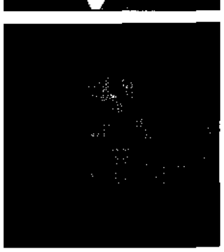
Albert J. Budney, Jr.
Age 61 ■ Dover, Massachusetts
Former President – Niagara Mohawk Holdings, Inc. and Niagara Mohawk Power Corporation
(Director since 2002)
Governance Committee *(Chair)*



Pastora San Juan Cafferty
Age 68 ■ Chicago, Illinois
Professor emerita – University of Chicago
(Director since 1988)
Environmental Committee
Governance Committee

Ellen Carnahan
Age 53 ■ Chicago, Illinois
Managing Director – William Blair Capital Management, LLC
(Director since 2003)
Audit Committee
Financial Committee

Robert C. Gallagher
Age 70 ■ Green Bay, Wisconsin
Former Chairman of the Board –
Associated Banc-Corp.
(Director since 1992)
Lead Director



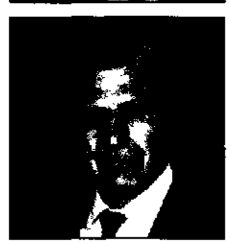
Kathryn M. Hasselblad-Pascale
Age 60 ■ Green Bay, Wisconsin
Managing Partner – Hasselblad Machine Company, LLP
(Director since 1987)
Environmental Committee *(Chair)*

John W. Higgins
Age 62 ■ Chicago, Illinois
Chairman and Chief Executive Officer –
Higgins Development Partners, LLC
(Director since 2003)
Audit Committee
Environmental Committee

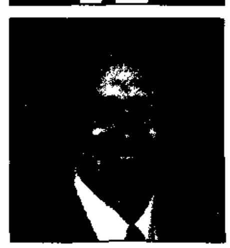
James L. Kemerling
Age 69 ■ Wausau, Wisconsin
President and Chief Executive Officer –
Riiser Oil Company, Inc.
(Director since 1988)
Financial Committee *(Chair)*

Michael E. Lavin
Age 62 ■ Chicago, Illinois
Former Midwest Area Managing Partner –
KPMG LLP
(Director since 2003)
Audit Committee *(Chair)*

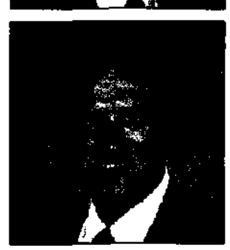
John C. Meng **
Age 64 ■ Green Bay, Wisconsin
Former Chairman of the Board –
Schreiber Foods, Inc.
(Director since 2000)
Compensation Committee *(Chair)*



William F. Protz, Jr.
Age 64 ■ Lake Forest, Illinois
Former President and Chief Executive Officer –
Santa's Best, LLP
(Director since 2001)
Audit Committee
Environmental Committee



Charles A. Schrock ***
Age 55 ■ Chicago, Illinois
President and Chief Executive Officer –
Integrys Energy Group, Inc.
(Director since 2009)



Larry L. Weyers
Age 63 ■ Chicago, Illinois
Executive Chairman – Integrys Energy Group, Inc.
(Director since 1996)

* *Age is as of December 31, 2008. Years as director take into consideration service with Integrys Energy Group or Peoples Energy Corporation.*

** *Resigned effective February 12, 2009.*

*** *Elected effective February 12, 2009.*

MANAGEMENT TEAM *

Lawrence T. Borgard
President and Chief Operating Officer –
Integrys Gas Group
Age 47 ■ Years of service 24

Charles A. Cloninger
President – Minnesota Energy Resources Corporation and
President – Michigan Gas Utilities Corporation
Age 50 ■ Years of service 27

Willard S. Evans, Jr.
President – The Peoples Gas Light and Coke Company and
President – North Shore Gas Company
Age 53 ■ Years of service 31

Diane L. Ford
Vice President and Corporate Controller
Age 55 ■ Years of service 33

Bradley A. Johnson
Vice President and Treasurer
Age 54 ■ Years of service 29

William D. Laakso
Vice President – Human Resources
Age 46 ■ Years of service 3

Thomas P. Meinz
Executive Vice President and Chief External Affairs Officer
Age 62 ■ Years of service 39

Phillip M. Mikulsky
Executive Vice President – Corporate Development and Shared Services
Age 60 ■ Years of service 37

Barbara A. Nick
President – Upper Peninsula Power Company
Age 50 ■ Years of service 24

Joseph P. O'Leary
Senior Vice President and Chief Financial Officer
Age 54 ■ Years of service 7

Mark A. Radtke
President and Chief Executive Officer –
Integrys Energy Services, Inc.
Age 47 ■ Years of service 25

Charles A. Schrock
President and Chief Executive Officer –
Integrys Energy Group ** and
President and Chief Executive Officer –
Wisconsin Public Service Corporation
Age 55 ■ Years of service 29

Larry L. Weyers
*Executive Chairman ***
Age 63 ■ Years of service 23

Barth J. Wolf
Vice President – Chief Legal Officer and Secretary
Age 51 ■ Years of service 20

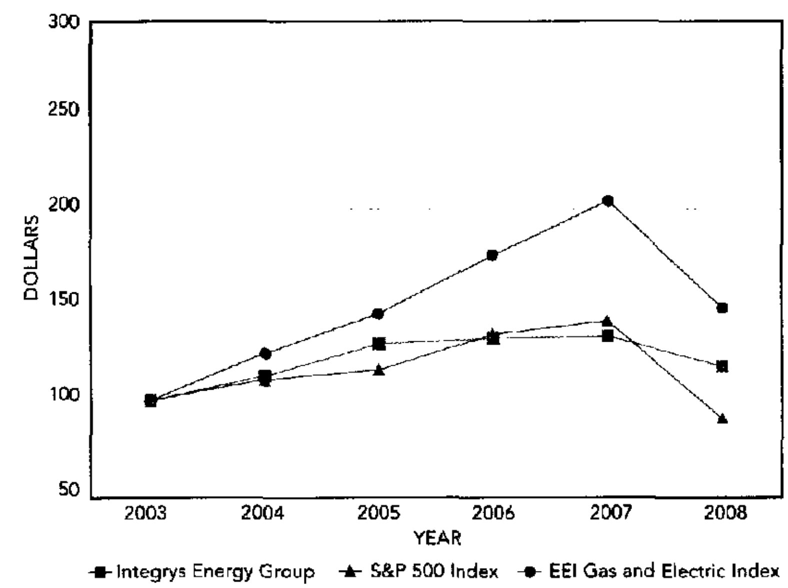
* *Title, age, and years of service are as of December 31, 2008. Years of service take into consideration service with Integrys Energy Group or a system company.*
** *Appointed to this position as of January 1, 2009.*

COMPARATIVE FIVE-YEAR INVESTMENT PERFORMANCE GRAPH (1)

The following graph presents a five-year comparison of:

- Integrys Energy Group's common stock cumulative total return,
- Standard & Poor's (S&P) 500 Index, and
- Edison Electric Institute (EEI) Gas and Electric Index for the last five fiscal years.

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN (2)



	2003	2004	2005	2006	2007	2008
Integrys Energy Group	100	113	130	133	134	118
S&P 500 Index	100	111	116	135	142	90
EEI Gas and Electric Index	100	125	146	177	206	149

Assumes $100 invested on December 31, 2003, in Integrys Energy Group Common Stock, S&P 500 Index, and EEI Gas and Electric Index.

(1) This performance graph is not to be deemed to be filed with the Securities and Exchange Commission, except to the extent specifically requested by Integrys Energy Group or incorporated by reference in documents otherwise filed.

(2) Total return assumes reinvestment of dividends.

SHAREHOLDER INQUIRIES

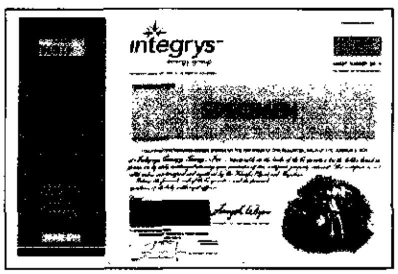
Our transfer agent, American Stock Transfer & Trust Company, can be reached via telephone between 7 a.m. and 6 p.m., Central time, Monday through Thursday, or 7 a.m. and 4 p.m., Central time, Friday, by calling 800-236-1551. You also have direct access to your account 24 hours a day through the Internet at www.amstock.com.

Our Investor Relations staff is also available to assist you by calling 800-228-6888 between 8 a.m. and 4:30 p.m., Central time, Monday through Friday.

Mailing addresses and Internet addresses, along with additional telephone numbers, are listed on the back cover of this report.

COMMON STOCK

The New York Stock Exchange is the principal market for Integrys Energy Group, Inc. common stock, which trades under the ticker symbol of TEG.



You may purchase or sell our common stock through our Stock Investment Plan described below or through brokerage firms and banks that offer brokerage services.

Common stock certificates issued before September 1, 1994, bear the name of Wisconsin Public Service Corporation and remain valid certificates. Common stock certificates issued from September 1, 1994, through February 21, 2007, bear the name of WPS Resources Corporation and remain valid certificates.

On December 31, 2008, we had 75,992,768 shares of common stock outstanding, which were owned by 34,016 holders of record.

DIVIDENDS

We have paid quarterly cash dividends on our common stock since 1953, and we expect to continue that trend subject to Board approval. Future dividends are dependent on regulatory limitations, earnings, capital requirements, cash flows, and other financial considerations.

Year Ended December 31 *(By Quarter)*

		Dividends Per Share	Price Range High	Price Range Low
[redacted]				
2007	1st quarter	$ .583	$58.04	$52.72
	2nd quarter	.660	60.63	50.11
	3rd quarter	.660	55.25	48.10
	4th quarter	.660	54.10	50.02
		$2.563		

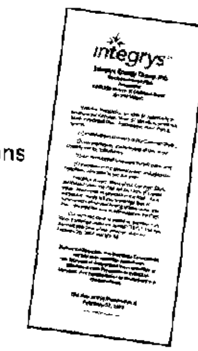
Anticipated record and payment dates for common stock dividends to be paid in 2009 are:

Record Date	Payment Date
February 27	March 20
May 29	June 20
August 31	September 19
November 30	December 19

If you are a record holder of our common stock, you may have your dividends electronically deposited in a checking or savings account at a financial institution. If you are a record holder and your dividends are not electronically deposited, we will mail your dividend check directly to you.

If you are a record holder of our common stock and your dividend check is not received on the payment date, wait approximately ten days to allow for delays in mail delivery. Then, contact American Stock Transfer & Trust Company to request a replacement check.

STOCK INVESTMENT PLAN



We maintain a Stock Investment Plan for the purchase of common stock, which allows persons who are not already shareholders to become participants by making a minimum initial cash investment of $100. Our Plan enables you to maintain registration with us in your own name rather than with a broker in "street name."

The Stock Investment Plan also provides you with options for reinvesting your dividends and making optional cash purchases of common stock directly through the Plan without paying brokerage commissions, fees, or service charges. Optional cash payments of not less than $25 per payment may be made subject to a maximum of $100,000 per calendar year. An automatic investment option allows you to authorize the deduction of payments from your checking or savings account automatically once each month, on the third day of the month, by electronic means for investment in the Plan.

Cash for investment must be received by the 3rd or 18th day of the month. Investment generally commences on or about the 5th or 20th day of the month, or as soon thereafter as practicable.

The shares you hold in our Stock Investment Plan may be sold by the agent for the Plan as you direct us, or you may request a certificate for sale through a broker you select. We will accumulate sale requests from participants and, approximately every five business days, will submit a sale request to the independent broker-dealer on behalf of those participants.

Participation in the Stock Investment Plan is being offered only by means of a prospectus. If you would like a copy of the Stock Investment Plan prospectus, you may use American

Stock Transfer & Trust Company's Web site at www.amstock.com, call American Stock Transfer & Trust Company at 800-236-1551, contact us by sending an e-mail to investor@integrysgroup.com, or order or download the prospectus and enrollment forms from our Web site at www.integrysgroup.com under "Investors."

SAFEKEEPING SERVICES

As a participant in the Stock Investment Plan, you may transfer shares of common stock registered in your name into a Plan account for safekeeping. Contact American Stock Transfer & Trust Company or our Investor Relations staff for details.

PREFERRED STOCK OF SUBSIDIARY

The preferred stock of Wisconsin Public Service Corporation trades on over-the-counter markets. Payment and record dates for preferred stock dividends to be paid in 2009 are:

Record Date	Payment Date
January 15	February 1
April 15	May 1
July 15	August 1
October 15	November 1

STOCK TRANSFER AGENT AND REGISTRAR

Questions about transferring common or preferred stock, lost certificates, or changing the name in which certificates are registered should be directed to our transfer agent, American Stock Transfer & Trust Company, at the addresses or telephone numbers listed on the back cover.

ADDRESS CHANGES

If your address changes, write to American Stock Transfer & Trust Company at the address on the back of this report or use their Web site at www.amstock.com.

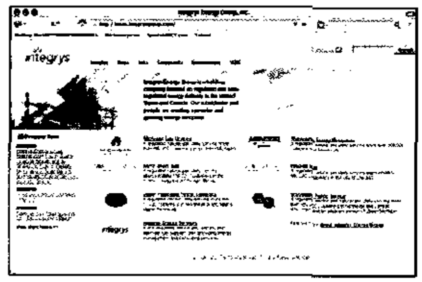
AVAILABILITY OF INFORMATION

Company financial information is available on our Web site at www.integrysgroup.com under Investors.

You may obtain, without charge, a copy of our 2008 Form 10-K, without exhibits, as filed with the Securities and Exchange Commission, by contacting the Corporate Secretary at the corporate office mailing address listed on the back cover, or by using our Web site.

INTERNET

Visit our Web site at www.integrysgroup.com to find a wealth of information about our company and its subsidiaries.



The site will give you instant access to Annual Reports, SEC filings, proxy statements, financial news, presentations, news releases, corporate governance, career opportunities, and much more. You may also download a copy of the prospectus for the Stock Investment Plan and the associated forms for participation in the Plan.

The site is updated regularly, so visit it often.

ANNUAL SHAREHOLDERS' MEETING

Our Annual Shareholders' Meeting will be held on Wednesday, May 13, 2009, at 10 a.m. Central daylight time at the Weidner Center, University of Wisconsin – Green Bay, 2420 Nicolet Drive, Green Bay, Wisconsin.

Proxy statements for our May 13, 2009, Annual Shareholders' Meeting were mailed to shareholders of record on April 3, 2009.

ANNUAL REPORT

If you or another member of your household receives more than one Annual Report because of differences in the registration of your accounts, please contact American Stock Transfer & Trust Company so account mailing instructions can be modified accordingly.

This Annual Report is prepared primarily for the information of our shareholders and is not given in connection with the sale of any security or offer to sell or buy any security.

CORPORATE GOVERNANCE INFORMATION

Corporate governance information, including our Corporate Governance Guidelines, our Code of Conduct, charters for the committees of our Board of Directors, By-Laws, and Articles of Incorporation, is available on our Web site at www.integrysgroup.com under "Investors." You may also obtain the information by written request to the Corporate Secretary at the mailing address for the corporate office indicated on the back cover of this report.

CERTIFICATIONS

We have filed as exhibits to our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, the certifications of our Chief Executive Officer and Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act. We also submitted to the New York Stock Exchange during 2008 the Annual CEO Certification required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.

Investor Relations
Integrys Energy Group, Inc.
700 North Adams Street
Green Bay, WI 54301

Mailing Address:
Integrys Energy Group, Inc.
P. O. Box 19001
Green Bay, WI 54307-9001

Telephone: 800-228-6888
Fax: 920-433-1526
E-Mail: investor@integrysgroup.com

Financial Analyst Inquiries
Steven P. Eschbach, CFA
Vice President – Investor Relations
Integrys Energy Group, Inc.
130 East Randolph Drive
Chicago, IL 60601
Telephone: 312-228-5408
E-Mail: speschbach@integrysgroup.com

TEG
LISTED
NYSE

Stock Exchange Listing
New York Stock Exchange
Ticker Symbol: TEG
Listing Abbreviation: IntegrysEngy

Transfer Agent and Registrar
For General Information:
American Stock Transfer & Trust Company, LLC
59 Maiden Lane
New York, NY 10038
Web Site: www.amstock.com
E-Mail: info@amstock.com
Telephone: 800-236-1551 (toll free), 718-921-8124 (international)
Fax: 718-236-2641

For Dividend Reinvestment and Direct Stock Purchase
American Stock Transfer & Trust Company, LLC
Wall Street Station
P. O. Box 922
New York, NY 10269-0560
Telephone: 800-236-1551 (toll free)

WISCONSIN UTILITY INVESTORS, INC.
With over 16,000 members, Wisconsin Utility Investors, Inc. (WUI) is an independent, non-profit organization representing the collective voices of all shareholders in Wisconsin utilities. It monitors and evaluates industry issues and trends and is a resource for its members, regulators, and the public. WUI can be reached by calling 608-663-5813 or by e-mail at contact@wuiinc.org.

MINNESOTA UTILITY INVESTORS, INC.
Minnesota Utility Investors, Inc. (MUI) is an independent, non-profit organization representing the collective voices of nearly 27,000 shareholders in electric and gas utilities operating in Minnesota. For more information, MUI can be reached by calling toll-free 888-850-5171 or by e-mail at mui@mnutilityinvestors.org.

EQUAL EMPLOYMENT OPPORTUNITY
Integrys Energy Group, Inc. is committed to equal employment opportunity for all qualified individuals without regard to race, color, religion, sex, national origin, age, sexual orientation, gender identity, disability, disabled veterans, recently separated veterans, other protected veterans, and armed forces service medal veterans, or any other protected class. To this end, we support and will cooperate fully with all applicable laws, regulations, and executive orders in all of our employment policies, practices, and decisions.

FSC **Mixed Sources** Product group from well-managed forests, controlled sources and recycled wood or fibre www.fsc.org Cert no. BV-COC-071211 © 1996 Forest Stewardship Council

10%

Printed on paper that contains 10% total recovered fiber/all post-consumer fiber, using environmentally conscientious vegetable inks.

Subjects in photos were not placed in unsafe conditions for the production of this Annual Report.

integrys™

Corporate Office
130 East Randolph Drive, Chicago, IL 60601
Telephone: 312-228-5400 Web Site: www.integrysgroup.com

ATTACHMENT F

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

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, Illinois 60601-6207 (312) 228-5400	39-1775292

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

Yes [X] No [ ]

Indicate by check mark 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).

Yes [ ] No [ ]

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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common stock, $1 par value,
77,017,367 shares outstanding at
May 5, 2010

INTEGRYS ENERGY GROUP, INC.
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2010

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Commonly Used Acronyms

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
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
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 Integrys Energy Group's Annual Report on Form 10-K for the year ended December 31, 2009, as may be amended or supplemented in Part II, Item 1A of this report. 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 1. FINANCIAL INFORMATION

Item 1. Financial Statements

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)	Three Months Ended March 31	
(Millions, except per share data)	2010	2009
Nonregulated revenues	$646.8	$1,786.3
Utility revenues	1,256.6	1,414.5
Total revenues	1,903.4	3,200.8
Nonregulated cost of fuel, natural gas, and purchased power	639.6	1,769.1
Utility cost of fuel, natural gas, and purchased power	741.5	910.6
Operating and maintenance expense	288.1	291.3
Goodwill impairment loss	-	291.1
Restructuring expense	2.7	-
Net loss on Integrys Energy Services' dispositions related to strategy change	39.8	-
Depreciation and amortization expense	64.2	56.9
Taxes other than income taxes	28.2	26.9
Operating income (loss)	119.3	(145.1)
Miscellaneous income	20.4	21.1
Interest expense	(39.4)	(42.7)
Other expense	(19.0)	(21.6)
Income (loss) before taxes	100.3	(166.7)
Provision for income taxes	50.1	12.8
Net income (loss) from continuing operations	50.2	(179.5)
Discontinued operations, net of tax	0.1	-
Net income (loss)	50.3	(179.5)
Preferred stock dividends of subsidiary	(0.8)	(0.8)
Noncontrolling interest in subsidiaries	-	0.1
Net income (loss) attributed to common shareholders	$49.5	($180.2)
Average shares of common stock		
Basic	76.9	76.7
Diluted	77.2	76.7
Earnings (loss) per common share (basic)		
Net income (loss) from continuing operations	$0.64	($2.35)
Discontinued operations, net of tax	-	-
Earnings (loss) per common share (basic)	$0.64	($2.35)
Earnings (loss) per common share (diluted)		
Net income (loss) from continuing operations	$0.64	($2.35)
Discontinued operations, net of tax	-	-
Earnings (loss) per common share (diluted)	$0.64	($2.35)
Dividends per common share declared	$0.68	$0.68

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

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited) (Millions)	March 31 2010	December 31 2009
Assets		
Cash and cash equivalents	$259.1	$44.5
Collateral on deposit	251.6	164.9
Accounts receivable and accrued unbilled revenues, net of reserves of $50.3 and $57.5, respectively	1,021.4	858.0
Inventories	94.9	304.3
Assets from risk management activities	753.7	1,522.1
Regulatory assets	119.9	121.1
Deferred income taxes	98.6	92.9
Assets held for sale	-	25.5
Other current assets	249.0	257.9
Current assets	2,848.2	3,512.2
Property, plant, and equipment, net of accumulated depreciation of $2,885.9 and $2,847.2, respectively	4,929.0	4,945.1
Regulatory assets	1,459.9	1,434.9
Assets from risk management activities	179.5	795.4
Goodwill	642.5	642.5
Other long-term assets	525.4	517.8
Total assets	$10,584.5	$11,847.9
Liabilities and Equity		
Short-term debt	$172.7	$222.1
Current portion of long-term debt	393.4	116.5
Accounts payable	536.9	639.4
Liabilities from risk management activities	946.2	1,607.1
Regulatory liabilities	114.3	100.4
Liabilities held for sale	-	0.3
Temporary LIFO liquidation credit	131.3	-
Other current liabilities	386.4	461.8
Current liabilities	2,681.2	3,147.6
Long-term debt	2,065.2	2,394.7
Deferred income taxes	692.3	658.2
Deferred investment tax credits	36.2	36.2
Regulatory liabilities	264.3	277.6
Environmental remediation liabilities	657.0	658.6
Pension and other postretirement benefit obligations	656.2	640.7
Liabilities from risk management activities	258.7	783.1
Asset retirement obligations	197.7	194.8
Other long-term liabilities	144.3	147.4
Long-term liabilities	4,982.9	5,791.5
Commitments and contingencies		
Common stock - $1 par value; 200,000,000 shares authorized; 76,806,208 shares issued; 76,407,822 shares outstanding	76.3	76.4
Additional paid-in capital	2,511.3	2,497.8
Retained earnings	343.0	345.6
Accumulated other comprehensive loss	(55.1)	(44.0)
Treasury stock and shares in deferred compensation trust	(15.7)	(17.2)
Total common shareholders' equity	2,860.3	2,858.6
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	(1.8)	(0.9)
Total liabilities and equity	$10,584.5	$11,847.9

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

ATTACHMENT F

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)	Three Months Ended March 31	
(Millions)	2010	2009
Operating Activities		
Net income (loss)	$80.3	($179.5)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Discontinued operations, net of tax	(0.1)	-
Goodwill impairment loss	-	291.1
Depreciation and amortization expense	64.2	56.9
Recoveries and refunds of regulatory assets and liabilities	14.6	19.6
Net unrealized losses on nonregulated energy contracts	71.7	105.0
Nonregulated lower of cost or market inventory adjustments	1.4	35.7
Bad debt expense	14.4	26.6
Pension and other postretirement expense	20.9	16.2
Pension and other postretirement contributions	(1.2)	(3.4)
Deferred income taxes and investment tax credit	27.5	(54.3)
(Gain) loss on sale of assets	38.6	(1.8)
Equity income, net of dividends	(3.2)	(3.9)
Other	(22.1)	10.0
Changes in working capital		
Collateral on deposit	(54.7)	(205.1)
Accounts receivable and accrued unbilled revenues	(71.8)	271.8
Inventories	200.8	467.4
Other current assets	17.5	62.0
Accounts payable	(24.4)	(319.3)
Temporary LIFO liquidation credit	131.2	128.6
Other current liabilities	(86.6)	130.0
Net cash provided by operating activities	419.4	852.8
Investing Activities		
Capital expenditures	(63.2)	(89.3)
Proceeds from the sale or disposal of assets	56.7	3.2
Purchase of equity investments	(5.1)	(8.8)
Other	(3.2)	1.2
Net cash used for investing activities	(15.8)	(93.5)
Financing Activities		
Short-term debt, net	(49.4)	(539.2)
Redemption of notes payable	-	(157.9)
Proceeds from sale of borrowed natural gas	20.7	107.6
Purchase of natural gas to repay natural gas loans	(2.9)	(36.0)
Repayment of long-term debt	(60.0)	-
Payment of dividends		
Preferred stock of subsidiary	(0.8)	(0.8)
Common stock	(46.5)	(51.7)
Issuance of common stock	7.7	-
Payments made on derivative contracts related to divestitures classified as financing activities	(66.9)	-
Other	(1.9)	(3.4)
Net cash used for financing activities	(189.1)	(681.5)
Change in cash and cash equivalents - continuing operations	214.5	77.6
Change in cash and cash equivalents - discontinued operations		
Net cash provided by investing activities	0.1	-
Net change in cash and cash equivalents	214.6	77.6
Cash and cash equivalents at beginning of period	44.6	254.1
Cash and cash equivalents at end of period	$259.1	$331.7

The accompanying condensed notes are an integral part of these statements

INTEGRYS ENERGY GROUP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO FINANCIAL STATEMENTS
March 31, 2010

NOTE 1–FINANCIAL INFORMATION

The condensed consolidated financial statements of Integrys Energy Group, Inc. have been prepared pursuant to the rules and regulations of the SEC for Quarterly Reports on Form 10-Q and in accordance with GAAP. Accordingly, these condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for annual financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes in the Integrys Energy Group Annual Report on Form 10-K for the year ended December 31, 2009.

The condensed consolidated financial statements are unaudited, but, in management's opinion, include all adjustments (which, unless otherwise noted, include only normal recurring adjustments) necessary for a fair presentation of such financial statements. Financial results for this interim period are not necessarily indicative of results that may be expected for any other interim period or for the year ending December 31, 2010.

NOTE 2–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 Condensed Consolidated Statements of Cash Flows:

	Three Months Ended March 31	
(Millions)	**2010**	**2009**
Cash paid for interest	**$23.5**	$29.7
Cash paid for income taxes	**11.5**	0.9

Significant non-cash transactions were:

	Three Months Ended March 31	
(Millions)	**2010**	**2009**
Construction costs funded through accounts payable	**$10.3**	$17.9
Equity issued for reinvested dividends	**5.6**	-
Equity issued for stock-based compensation plans	**3.0**	-
Intangible assets (customer contracts) received in exchange for risk management assets	-	9.2

NOTE 3--RISK MANAGEMENT ACTIVITIES

In the three months ended March 31, 2010, Integrys Energy Group identified additional classes of risk management assets and liabilities as a result of the implementation of FASB Accounting Standards Update (ASU) 2010-06, "Fair Value Measurements and Disclosures (Topic 820), Improving Disclosures about Fair Value Measurements." As required, this ASU was only applied for the quarter ended March 31, 2010, and therefore, prior periods do not reflect the expanded disclosure requirements.

The following tables show Integrys Energy Group's assets and liabilities from risk management activities.

		March 31, 2010	
(Millions)	**Balance Sheet Presentation ***	**Risk Management Assets**	**Risk Management Liabilities**
Utility Segments			
Non-hedge derivatives			
Natural gas contracts	Current	$ 0.5	$ 47.7
Natural gas contracts	Long-term	0.8	5.3
Financial transmission rights	Current	1.9	0.4
Petroleum product contracts	Current	0.2	-
Total commodity contracts	**Current**	**2.6**	**48.1**
Total commodity contracts	**Long-term**	**0.8**	**5.3**
Cash flow hedges			
Natural gas contracts	Current	-	0.9
Natural gas contracts	Long-term	-	0.4
Nonregulated Segments			
Non-hedge derivatives			
Natural gas contracts	Current	189.4	186.4
Natural gas contracts	Long-term	92.2	90.6
Power contracts	Current	557.2	670.5
Power contracts	Long-term	83.4	142.1
Total commodity contracts	**Current**	**746.6**	**856.9**
Total commodity contracts	**Long-term**	**175.6**	**232.7**
Interest rate swaps	Current	-	0.8
Interest rate swaps	Long-term	-	2.6
Foreign exchange contracts	Current	1.0	1.0
Foreign exchange contracts	Long-term	0.8	0.8
Fair value hedges			
Interest rate swaps	Current	1.9	-
Cash flow hedges			
Natural gas contracts	Current	0.4	4.9
Natural gas contracts	Long-term	-	0.1
Power contracts	Current	1.2	32.7
Power contracts	Long-term	2.3	16.8
Total commodity contracts	**Current**	**1.6**	**37.6**
Total commodity contracts	**Long-term**	**2.3**	**16.9**
Interest rate swaps	Current	-	0.9
	Current	**753.7**	**946.2**
	Long-term	**179.5**	**258.7**
Total		**$933.2**	**$1,204.9**

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

(Millions)	Balance Sheet Presentation *	December 31, 2009 Risk Management Assets	Risk Management Liabilities
Utility Segments			
Non-hedge derivatives			
Commodity contracts	Current	$ 10.8	$ 24.7
Commodity contracts	Long-term	2.0	1.5
Cash flow hedges			
Commodity contracts	Current	-	0.2
Commodity contracts	Long-term	-	0.1
Nonregulated Segments			
Non-hedge derivatives			
Commodity contracts	Current	1,503.9	1,548.4
Commodity contracts	Long-term	787.2	769.5
Interest rate swaps	Current	-	1.0
Interest rate swaps	Long-term	-	2.5
Foreign exchange contracts	Current	1.0	0.9
Foreign exchange contracts	Long-term	0.9	0.9
Fair value hedges			
Commodity contracts	Current	-	-
Interest rate swaps	Current	1.8	-
Interest rate swaps	Long-term	0.8	-
Cash flow hedges			
Commodity contracts	Current	4.6	30.1
Commodity contracts	Long-term	4.5	8.6
Interest rate swaps	Current	-	1.8
Interest rate swaps	Long-term	-	-
Foreign exchange contracts	Current	-	-
	Current	1,522.1	1,607.1
	Long-term	795.4	783.1
Total		$2,317.5	$2,390.2

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

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

(Millions)	March 31, 2010	December 31, 2009
Cash collateral provided to others	$251.6 **	$184.8
Cash collateral received from others	47.2	55.2

** On April 1, 2010, $212.2 million of cash was recovered from a counterparty, and replaced with a letter of credit.

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 March 31, 2010, and December 31, 2009, was $800.6 million and $579.6 million, respectively.

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, Integrys Energy Group would have been required to post collateral of $616.2 million and $566.3 million at March 31, 2010, and December 31, 2009, respectively. Of these amounts, Integrys Energy Group had already satisfied $335.9 million at March 31, 2010, of which $212.2 million was satisfied with cash and the difference was satisfied with letters of credit, and $51.9 million at December 31, 2009, all satisfied with letters of credit. Therefore, the remaining collateral requirement would have been $280.3 million at March 31, 2010, and $514.4 million at December 31, 2009.

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 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.

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. 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.

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

(Millions)	Financial Statement Presentation	Three Months Ended March 31, 2010
Natural gas contracts	Balance Sheet – Regulatory assets (current)	$(26.4)
Natural gas contracts	Balance Sheet – Regulatory assets (long-term)	(5.2)
Natural gas contracts	Balance Sheet – Regulatory liabilities (current)	(0.2)
Financial transmission rights	Balance Sheet – Regulatory assets (current)	0.9
Financial transmission rights	Balance Sheet – Regulatory liabilities (current)	(2.3)
Petroleum product contracts	Income Statement – Operating and maintenance expense	(0.1)

(Millions)	Financial Statement Presentation	Three Months Ended March 31, 2009
Commodity contracts	Balance Sheet – Regulatory assets (current)	$15.8
Commodity contracts	Balance Sheet – Regulatory assets (long-term)	0.3
Commodity contracts	Balance Sheet – Regulatory liabilities (current)	(2.7)
Commodity contracts	Income Statement – Utility cost of fuel, natural gas, and purchased power	0.2

The utilities had the following notional volumes of outstanding non-hedge derivative contracts:

	March 31, 2010		December 31, 2009	
	Purchases	Other Transactions	Purchases	Other Transactions
Natural gas (millions of therms)	667.4	N/A	833.2	N/A
Financial transmission rights (millions of kilowatt-hours)	N/A	2,287.9	N/A	4,546.6
Petroleum products (barrels)	31,869	N/A	42,823	N/A

Cash Flow Hedges

PGL uses natural gas 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. PGL had the following notional volumes of outstanding contracts that were designated as cash flow hedges:

	Purchases	
	March 31, 2010	December 31, 2009
Natural gas (millions of therms)	9.0	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.

Unrealized Loss Recognized in OCI on Derivative Instruments (Effective Portion)

	Three Months Ended March 31	
(Millions)	2010	2009
Natural gas contracts	$(1.1)	$(0.6)

Loss Reclassified from Accumulated OCI into Income (Effective Portion)

		Three Months Ended March 31	
(Millions)	Income Statement Presentation	2010	2009
Settled natural gas contracts	Operating and maintenance expense	$(0.1)	$(0.1)

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 the three months ended March 31, 2010, and 2009. Cash flow hedge ineffectiveness related to these natural gas contracts was not significant during the three months ended March 31, 2010, and 2009. 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 and interest rate risk associated with expected future natural gas purchases.

The nonregulated segments had the following notional volumes of outstanding non-hedge derivative contracts:

	March 31, 2010			December 31, 2009		
(Millions)	Purchases	Sales	Other Transactions	Purchases	Sales	Other Transactions
Commodity contracts						
Natural gas (therms)	1,704.5	1,479.4	N/A	2,990.4	2,917.1	N/A
Power (kilowatt-hours)	46,004.2	40,160.4	N/A	132,200.4	125,983.1	N/A
Interest rate swaps	N/A	N/A	$192.6	N/A	N/A	$219.2
Foreign exchange contracts	$31.4	$31.4	N/A	$35.1	$35.1	N/A

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

(Millions)	Income Statement Presentation	Three Months Ended March 31, 2010
Natural gas contracts	Nonregulated revenue	$ 3.2
Natural gas contracts	Nonregulated revenue (reclassified from accumulated OCI)	0.3 *
Power contracts	Nonregulated revenue	(80.7)
Interest rate swaps	Interest expense	(0.4)
Total		$(77.6)

* Represents amounts reclassified from accumulated OCI related to cash flow hedges that were dedesignated in prior periods.

(Millions)	Income Statement Presentation	Three Months Ended March 31, 2009
Commodity contracts	Nonregulated revenue	$(39.6)
Interest rate swaps	Interest expense	0.1
Foreign exchange contracts	Nonregulated revenue	0.1
Total		$(39.4)

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.

		Three Months Ended March 31	
(Millions)	Income Statement Presentation	2010	2009
Interest rate swap	Interest expense	$(0.7)	$(0.3)
Debt hedged by swap	Interest expense	0.7	0.3
Total		$ -	$ -

Fair value hedge ineffectiveness recorded in interest expense on the Condensed Consolidated Statements of Income was not significant for the three months ended March 31, 2010, and 2009. No amounts were excluded from effectiveness testing related to the interest rate swap during the three months ended March 31, 2010, and 2009.

Cash Flow Hedges

Natural gas futures, forwards, and swaps that are designated as cash flow hedges extend through January 2012, while power futures, forwards, and swaps designated as cash flow hedges extend through May 2013. These contracts are used to mitigate the risk of cash flow variability associated with future purchases and sales of natural gas and power. 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. The nonregulated segments had the following notional volumes of outstanding contracts that were designated as cash flow hedges:

(Millions)	March 31, 2010 Purchases	March 31, 2010 Sales	March 31, 2010 Other Transactions	December 31, 2009 Purchases	December 31, 2009 Sales	December 31, 2009 Other Transactions
Commodity contracts						
Natural gas (therms)	65.9	10.1	N/A	5.9	8.6	N/A
Power (kilowatt-hours)	6,982.7	-	N/A	7,116.2	-	N/A
Interest rate swaps	N/A	N/A	$65.5	N/A	N/A	$65.6

Changes in the fair values of the effective portions of contracts designated as cash flow hedges are included in OCI, net of taxes. Amounts recorded in OCI related to 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.

Unrealized Gain (Loss) Recognized in OCI on Derivative Instruments (Effective Portion)

(Millions)	Three Months Ended March 31, 2010
Natural gas contracts	$ (4.2)
Power contracts	(23.9)
Interest rate swaps	1.0
Total	$(27.1)

Unrealized Gain (Loss) Recognized in OCI on Derivative Instruments (Effective Portion)

(Millions)	Three Months Ended March 31, 2009
Commodity contracts	$(50.0)
Interest rate swaps	0.9
Total	$(49.1)

Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)

(Millions)	Income Statement Presentation	Three Months Ended March 31, 2010
Settled/Realized		
Natural gas contracts	Nonregulated revenue	$ (7.3)
Power contracts	Nonregulated revenue	(4.9)
Interest rate swaps	Interest expense	0.3
Hedge Designation Discontinued		
Natural gas contracts	Nonregulated revenue	0.8
Power contracts	Nonregulated revenue	(7.6)
Total		$(18.7)

Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)

(Millions)	Income Statement Presentation	Three Months Ended March 31, 2009
Settled/Realized		
Commodity contracts	Nonregulated revenue	$16.7
Interest rate swaps	Interest expense	0.3
Hedge Designation Discontinued		
Commodity contracts	Nonregulated revenue	(0.5)
Total		$16.5

Loss Recognized in Income on Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing

(Millions)	Income Statement Presentation	Three Months Ended March 31, 2010
Power contracts	Nonregulated revenue	$(0.7)

Loss Recognized In Income on Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing

(Millions)	Income Statement Presentation	Three Months Ended March 31, 2009
Commodity contracts	Nonregulated revenue	$(0.8)

In the next 12 months, subject to changes in market prices of natural gas and electricity, pre-tax losses of $7.4 million, and $34.7 million related to cash flow hedges of natural gas contracts, and power contracts, respectively, are expected to be recognized in earnings as the hedged transactions occur. These amounts are expected to be substantially offset by the settlement of the related nonderivative hedged contracts.

NOTE 4–RESTRUCTURING EXPENSE

Reductions in Workforce

In an effort to permanently remove costs from its operations, Integrys Energy Group developed a plan at the end of 2009 that included reductions in its workforce. In connection with this plan, $0.2 million of employee-related and consulting costs were included in the restructuring expense line item on the Condensed Consolidated Statement of Income for the three months ended March 31, 2010.

The following table summarizes the activity related to these restructuring costs:

(Millions)	Three Months Ended March 31, 2010
Accrued restructuring costs at beginning of period	$18.0
Restructuring costs accrued during the period	0.5 *
Cash payments	(8.5)
Accrued restructuring costs at end of period	**$10.0**

* $0.3 million of these restructuring costs are being billed to certain companies in accordance with provisions in the operating agreements with these companies that allow WPS to recover a portion of its administrative and general expenses.

Integrys Energy Services Strategy Change

Integrys Energy Group has substantially completed the process of repositioning Integrys Energy Services from focusing on significant growth in wholesale and retail markets across the United States and Canada, to focusing on selected retail markets in the United States and investments in energy assets with renewable attributes. In connection with this strategy, the following restructuring costs were expensed during the three months ended March 31, 2010:

(Millions)	
Employee-related costs	$1.3
Legal and consulting	0.9
Miscellaneous	0.3
Total restructuring expense	**$2.5**

All of the above costs were related to the Integrys Energy Services segment and were included in the restructuring expense line item on the Condensed Consolidated Statements of Income.

The following table summarizes the activity related to employee-related restructuring expense:

(Millions)	Three Months Ended March 31, 2010
Accrued employee-related costs at beginning of period	$8.2
Add: Employee-related costs expensed	1.3
Less: Cash payments	5.1
Accrued employee-related costs at end of period	**$4.4**

Integrys Energy Group expects to incur total employee-related restructuring expense of approximately $13 million related to the Integrys Energy Services strategy change by the end of 2010, including the $11.4 million expensed through March 31, 2010, of which $10.1 million was expensed in 2009.

NOTE 5--DISPOSITIONS

Integrys Energy Services Strategy Change

As part of Integrys Energy Group's decision to reposition its nonregulated energy services business segment to focus on selected retail markets in the United States and investments in energy assets with renewable attributes, Integrys Energy Services completed the following sales in 2010.

Sale of Renewable Energy Certificates Portfolio

On March 12, 2010, Integrys Energy Services sold its environmental markets business, which consisted of a portfolio of long-term renewable energy certificate contracts with generators, wholesalers, municipalities, cooperatives, and large industrial companies. The pre-tax gain on the sale of the renewable energy certificate contracts was $2.8 million and was reported as a component of net loss on Integrys Energy Services' dispositions related to strategy change in the Condensed Consolidated Statements of Income.

Sale of United States Wholesale Electric Marketing and Trading Business

In December, 2009, Integrys Energy Services entered into a definitive agreement to sell substantially all of its United States wholesale electric marketing and trading business. Effective February 1, 2010, Integrys Energy Services transferred substantially all of the market risk associated with this business by entering into trades with the buyer that mirrored Integrys Energy Services' underlying wholesale electric contracts. On March 31, 2010, Integrys Energy Services closed on the sale and transferred title to the majority of the underlying commodity contracts, upon which time the corresponding mirror transactions terminated. The majority of the remaining underlying commodity contracts that had not been novated as of March 31, 2010 are expected to be either transferred after they are ultimately novated, or if never novated, will be settled through the normal course of business in the second quarter of 2010, at which time the corresponding mirror transactions will terminate.

In connection with this sale, for a two-year period following the closing, Integrys Energy Services will retain counterparty default risk with approximately 50% of the counterparties to the commodity contracts transferred. The fair value of the counterparty payment default risk is $0.8 million and was reported as a component of other long-term liabilities.

The following table shows the carrying values of the major classes of assets and liabilities included in the sale at the March 31, 2010 closing date:

(Millions)	
Current assets from risk management activities	$1,375.5
Long-term assets from risk management activities	683.3
Total assets	**$2,058.8**
Current liabilities from risk management activities	$1,389.8
Long-term liabilities from risk management activities	654.3
Total liabilities	**$2,044.1**

In addition to the above recognized assets and liabilities, commodity contracts that are not accounted for as derivatives were also transferred to the buyer.

In conjunction with the sale, Integrys Energy Services entered into derivative contracts with the buyer to reestablish the economic hedges for the retained United States retail electric business, at the same prices and other terms previously executed through Integrys Energy Services' United States wholesale electric marketing and trading business that was sold. The execution of these new third-party derivative contracts resulted in assets and liabilities from risk management activities at the closing date as follows:

(Millions)	
Current assets from risk management activities	$20.3
Long-term assets from risk management activities	10.3
Total assets	**$30.6**
Current liabilities from risk management activities	$65.6
Long-term liabilities from risk management activities	23.9
Total liabilities	**$89.5**

The following table shows the carrying values of the remaining underlying commodity contracts that had not been novated at the March 31, 2010 closing date:

(Millions)	
Current assets from risk management activities	$289.5
Current liabilities from risk management activities	$117.2

The following table shows the carrying values of the remaining mirror transactions associated with the underlying commodity contracts referenced above that had not been novated at the March 31, 2010 closing date:

(Millions)	
Current assets from risk management activities	$130.6
Current liabilities from risk management activities	$282.9

The pre-tax loss on the sale of the United States wholesale electric marketing and trading business was $64.9 million and was reported as a component of net loss on Integrys Energy Services' dispositions related to strategy change in the Condensed Consolidated Statements of Income.

Effective March 1, 2010, Integrys Energy Services closed on its remaining wholesale electric commodity contract with another buyer. The pre-tax gain on the sale of the commodity contract was $8.7 million and was reported as a component of net loss on Integrys Energy Services' dispositions related to strategy change in the Condensed Consolidated Statements of Income.

Sale of Generation Businesses in New Brunswick, Canada and Northern Maine, and Associated Retail Electric Contracts

During January 2010, Integrys Energy Services closed on the sale of two of its power generation businesses, which owned generation assets in New Brunswick, Canada and Northern Maine, and subsequently closed on the sale of the associated retail electric contracts and standard offer service contracts in Northern Maine on February 1, 2010. The proceeds from the sale of the generation companies and associated retail electric contracts were $38.5 million. The pre-tax gain on the sale was $15.7 million and was reported as a component of net loss on Integrys Energy Services' dispositions related to strategy change in the Condensed Consolidated Statements of Income.

The carrying values of the major classes of assets and liabilities included in the sale as of the closing dates and classified as held for sale on the Condensed Consolidated Balance Sheets at December 31, 2009 were as follows:

(Millions)	**As of the Closing Dates**	**December 31, 2009**
Inventories	**$ 0.1**	**$ 0.1**
Property, plant, and equipment, net	**25.1**	**25.1**
Other long-term assets	**1.3**	**1.3**
Total assets	**$26.5**	**$26.5**
Other current liabilities	**$ 0.1**	**$ -**
Asset retirement obligations	***0.3***	**0.3**
Total liabilities	**$ 0.4**	**$ 0.3**

In conjunction with the sale, Integrys Energy Services entered into derivative contracts with the buyer of the Northern Maine retail electric sales contracts to maintain the economic hedges associated with the customer contracts sold. As of the closing date, the carrying values of the derivative contracts were as follows:

(Millions)	
Current assets from risk management activities	***$3.6***
Long-term assets from risk management activities	**0.2**
Total assets	**$3.8**
Current liabilities from risk management activities	**$0.4**
Total liabilities	**$0.4**

Sale of United States Wholesale Natural Gas Marketing and Trading Business & Other Wholesale Natural Gas Storage Contracts

In October 2009, Integrys Energy Services entered into definitive agreements to sell the majority of its United States wholesale natural gas marketing and trading business in a two-part transaction. In December 2009, Integrys Energy Services completed the first part of the transaction by selling substantially all of its United States wholesale natural gas marketing and trading business.

The second part of the transaction consisted of an option for the buyer to purchase certain natural gas storage and related transportation contracts. In January 2010, the buyer of the United States wholesale natural gas marketing and trading business exercised its option to purchase these wholesale natural gas storage and related transportation contracts from Integrys Energy Services in a subsequent sale. The pre-tax loss on the sale of these natural gas storage contracts was $1.3 million and was reported as a component of net loss on Integrys Energy Services' dispositions related to strategy change in the Condensed Consolidated Statements of Income.

Integrys Energy Services continued to pursue the sale of its remaining United States wholesale natural gas storage contracts as part of its strategy change, and in March 2010, Integrys Energy Services closed on the sale of two of these remaining storage contracts. The pre-tax loss on the sale of these natural gas storage contracts was $0.8 million and was reported as a component of net loss on Integrys Energy Services' dispositions related to strategy change in the Condensed Consolidated Statements of Income. The carrying value of inventories included in the sales was $1.8 million as of the closing date. Integrys Energy Services closed on the remaining United States wholesale natural gas storage contracts during the second quarter of 2010.

Discontinued Operations Resulting from Integrys Energy Services Strategy Change

Energy Management Consulting Business

During the three months ended March 31, 2010, Integrys Energy Services recorded a $0.1 million after-tax gain in discontinued operations when a contingent payment was earned from the buyer. This contingent payment resulted from the ability of the buyer to bill customers under assigned contracts related to the sale of Integrys Energy Services' energy management consulting business, which occurred in July 2009.

NOTE 6—INVESTMENTS IN AFFILIATES, AT EQUITY METHOD

Integrys Energy Group's electric transmission investment segment consists of WPS Investments LLC's ownership interest in ATC, which was approximately 34% at March 31, 2010. ATC is a for-profit, transmission-only company. ATC owns, maintains, monitors, and operates electric transmission assets in portions of Wisconsin, Michigan, Minnesota, and Illinois.

The following table shows changes to Integrys Energy Group's investment in ATC during the three months ended March 31, 2010, and 2009.

(Millions)	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Balance at the beginning of period	$395.9	$346.9
Equity in net income	19.5	18.0
Capital contributions	5.1	8.5
Dividends received	(16.3)	(14.6)
Balance at the end of period	$404.2	$358.8

ATC total company financial data is included in the following tables:

(Millions)	Three Months Ended March 31 2010	2009
Income statement data		
Revenues	$138.5	$126.2
Operating expenses	62.8	57.0
Other expense	20.6	18.3
Net income *	$ 55.1	$ 50.9

* As most income taxes are the responsibility of its members, ATC does not report a provision for its members' income taxes in its income statements.

(Millions)	March 31, 2010	December 31, 2009
Balance sheet data		
Current assets	$ 54.5	$ 51.1
Noncurrent assets	2,801.6	2,767.3
Total assets	$2,856.1	$2,818.4
Current liabilities	$ 495.7	$ 285.5
Long-term debt	1,059.7	1,259.7
Other noncurrent liabilities	78.9	76.8
Members' equity	1,221.8	1,196.4
Total liabilities and members' equity	$2,856.1	$2,818.4

NOTE 7--INVENTORIES

PGL and NSG price natural gas storage injections at the calendar year average of the cost of natural gas supply purchased. Withdrawals from storage are priced on the LIFO cost method. For interim periods, the difference between current projected replacement cost and the LIFO cost for quantities of natural gas temporarily withdrawn from storage is recorded as a temporary LIFO liquidation debit or credit. Due to seasonality requirements, PGL and NSG expect interim reductions in LIFO layers to be replenished by year-end.

NOTE 8--GOODWILL AND OTHER INTANGIBLE ASSETS

Integrys Energy Group had no changes to the carrying amount of goodwill during the first quarter of 2010. The goodwill recorded at Integrys Energy Group as of March 31, 2010, was as follows:

(Millions)	Natural Gas Utility Segment	Integrys Energy Services	Total
Total goodwill	$635.9	$ 6.6	$642.5

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, triggering an interim goodwill impairment analysis. Based upon the results of the interim goodwill impairment analysis, Integrys Energy Group recorded a non-cash goodwill impairment loss of $291.1 million ($248.8 million after-tax) in the first quarter of 2009, all 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, and the negative impact that the global decline in equity markets had on the valuation of natural gas distribution companies in general.

Identifiable intangible assets other than goodwill are included as a component of other current and long-term assets and other current and long-term liabilities within the Condensed Consolidated Balance Sheets as listed below.

(Millions)	March 31, 2010			December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Amortized intangible assets (liabilities)						
Customer-related [1]	$ 32.6	$(19.2)	$13.4	$ 32.6	$(18.3)	$14.3
Natural gas and electric contract assets [2] [3]	65.2	(55.8)	9.4	71.4	(60.5)	10.9
Natural gas and electric contract liabilities [2]	(10.5)	10.5	-	(10.5)	10.4	(0.1)
Renewable energy credits [4]	3.0	(2.6)	0.4	3.4	(2.1)	1.3
Nonregulated easements [5]	3.7	(0.2)	3.5	3.6	(0.1)	3.5
Emission allowances [6]	1.9	(0.1)	1.8	2.1	(0.2)	1.9
Other	2.3	(0.3)	2.0	2.5	(0.5)	2.0
Total	$98.2	$(67.7)	$30.5	$105.1	$(71.3)	$33.8
Unamortized intangible assets						
MGU trade name	5.2	-	5.2	5.2	-	5.2
Total intangible assets	$103.4	$(67.7)	$35.7	$110.3	$(71.3)	$39.0

(1) Includes customer relationship assets associated with both PEC's former nonregulated retail natural gas and electric operations and MERC's nonutility ServiceChoice business. The remaining weighted-average amortization period for customer-related intangible assets at March 31, 2010, was approximately 7 years.

(2) Represents the fair value of certain PEC natural gas and electric customer contracts acquired in the February 2007 PEC merger that were not considered to be derivative instruments, as well as other electric customer contracts acquired in exchange for risk management assets.

(3) Includes both short-term and long-term intangible assets related to customer contracts in the amount of $5.4 million and $4.0 million, respectively, at March 31, 2010, and $6.2 million and $4.7 million, respectively, at December 31, 2009. The remaining weighted-average amortization period for these intangible assets at March 31, 2010, was approximately 3 years.

(4) Used at Integrys Energy Services to comply with state Renewable Portfolio Standards and to support customer commitments.

(5) Relates to easements supporting a pipeline at Integrys Energy Services. The easements are amortized on a straight-line basis, with a remaining amortization period of approximately 14 years.

(6) Emission allowances do not have a contractual term or expiration date.

Intangible asset amortization expense, excluding amortization related to natural gas and electric contracts, was recorded as a component of depreciation and amortization expense. Amortization for the three months ended March 31, 2010, and 2009, was $1.8 million and $1.4 million, respectively.

Amortization expense for the next five fiscal years is estimated to be:

(Millions)	
For year ending December 31, 2010	$5.2
For year ending December 31, 2011	3.5
For year ending December 31, 2012	2.5
For year ending December 31, 2013	1.8
For year ending December 31, 2014	1.6

Amortization of the natural gas and electric contract intangible assets and liabilities was recorded as a component of nonregulated cost of fuel, natural gas, and purchased power. Amortization of these contracts for the three months ended March 31, 2010, resulted in an increase to nonregulated cost of fuel, natural gas, and purchased power of $1.4 million. Amortization of these contracts for the three months ended March 31, 2009, resulted in a decrease to nonregulated fuel, natural gas, and purchased power of $1.4 million.

Amortization expense related to these contracts for the next five fiscal years is estimated to be:

(Millions)	
For year ending December 31, 2010	$6.1
For year ending December 31, 2011	2.8
For year ending December 31, 2012	1.1
For year ending December 31, 2013	0.5
For year ending December 31, 2014	0.3

NOTE 9--SHORT-TERM DEBT AND LINES OF CREDIT

Integrys Energy Group's outstanding short-term borrowings consisted of sales of commercial paper and short-term notes.

(Millions, except percentages)	March 31, 2010	December 31, 2009
Commercial paper outstanding	**$162.7**	$212.1
Average discount rate on outstanding commercial paper	**0.36%**	0.52%
Short-term notes payable outstanding	**$10.0**	$10.0
Average interest rate on outstanding short-term notes payable	**0.18%**	0.18%

The commercial paper outstanding at March 31, 2010, had varying maturity dates ranging from April 1, 2010, through April 27, 2010.

The table below presents Integrys Energy Group's average amount of short-term borrowings outstanding based on daily outstanding balances during the quarters ended March 31:

(Millions)	2010	2009
Average amount of commercial paper outstanding	**$183.9**	$352.1
Average amount of borrowings under revolving credit facilities	**-**	408.3
Average amount of short-term notes payable outstanding	**10.0**	164.0

Integrys Energy Group manages its liquidity by maintaining adequate external financing commitments. The information in the table below relates to Integrys Energy Group's short-term debt, lines of credit, and remaining available capacity:

(Millions)	Maturity	March 31, 2010	December 31, 2009
Revolving credit facility (Integrys Energy Group) [1]	6/02/10	$ 500.0	$ 500.0
Revolving credit facility (Integrys Energy Group)	6/09/11	500.0	500.0
Revolving credit facility (Integrys Energy Group) [1]	5/26/10	425.0	425.0
Revolving credit facility (Integrys Energy Group) [1]	6/04/10	35.0	35.0
Revolving credit facility (WPS) [2]	6/02/10	115.0	115.0
Revolving credit facility (PEC)	6/13/11	400.0	400.0
Revolving credit facility (PGL) [3]	7/12/10	250.0	250.0
Revolving short-term notes payable (WPS) [4]	11/13/10	10.0	10.0
Total short-term credit capacity		2,235.0	2,235.0
Less:			
Letters of credit issued inside credit facilities		333.7	130.4
Loans outstanding under credit agreements and notes payable		10.0	10.0
Commercial paper outstanding		162.7	212.1
Available capacity under existing agreements		$1,728.6	$1,882.5

[1] These facilities were replaced with a new revolving credit agreement in April 2010 and provide support for Integrys Energy Group's commercial paper borrowing program. Upon entering into the new agreement, the maturing facilities were terminated. The new revolving credit agreement allows for borrowings up to $735.0 million and will mature on April 23, 2013.

[2] In April 2010, WPS entered into a new revolving credit agreement to provide support for its commercial paper borrowing program. Upon entering into the new agreement, the maturing facility was terminated. The new revolving credit agreement allows for borrowings up to $115.0 million and will mature on April 23, 2011. WPS intends to request authority to enter into a multi-year credit agreement from the PSCW, and if granted, the credit facility will mature on April 23, 2013.

[3] In April 2010, PGL entered into a new revolving credit agreement to provide support for its commercial paper borrowing program. Upon entering into the new agreement, the maturing facility was terminated. The new revolving credit agreement allows for borrowings up to $250.0 million and will mature on April 23, 2013.

[4] This note is renewed every six months and is used for general corporate purposes.

At March 31, 2010, Integrys Energy Group and its subsidiaries were in compliance with all financial covenants related to outstanding short-term debt. Integrys Energy Group's and certain subsidiaries' revolving credit agreements contain financial and other covenants, including but not limited to, a requirement to maintain a debt to total capitalization ratio not to exceed 65%, excluding non-recourse debt. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements.

NOTE 10--LONG-TERM DEBT

(Millions)	March 31, 2010	December 31, 2009
WPS	$ 872.1	$ 872.1
UPPCO [(1)]	10.8	10.8
PEC [(2)]	326.9	327.6
PGL [(3)]	526.0	576.0
NSG	75.0	75.0
Integrys Energy Group	555.0	555.0
Unsecured term loan – Integrys Energy Group [(4)]	65.6	65.6
Other term loan [(5)]	27.0	27.0
Total	2,458.4	2,509.1
Unamortized discount and premium	1.2	2.1
Total debt	2,459.6	2,511.2
Less current portion	(393.4)	(116.5)
Total long-term debt	$2,066.2	$2,394.7

(1) Prior to November 1, 2010, UPPCO will make a $0.9 million sinking fund payment under the terms of its First Mortgage Bonds. As a result, this payment is included in the current portion of long-term debt on Integrys Energy Group's Condensed Consolidated Balance Sheets at March 31, 2010.

(2) In January 2011, PEC's $325.0 million, 6.9% unsecured Senior Notes will mature. PEC also expects to settle an interest rate swap designated as a fair value hedge associated with $50.0 million of the senior notes in January 2011. At March 31, 2010, the value of the fair value hedge adjustment was $1.9 million. See Note 3, "*Risk Management Activities*," for more information on the PEC fair value hedge adjustment. As a result, the notes and fair value hedge adjustment are included in the current portion of long-term debt on Integrys Energy Group's Condensed Consolidated Balance Sheets at March 31, 2010.

(3) PGL has outstanding $51.0 million of Adjustable Rate, Series OO bonds, due October 1, 2037, which are currently in a 35-day Auction Rate mode (the interest rate is reset every 35 days through an auction process). Recent auctions have failed to receive sufficient clearing bids. As a result, these bonds are priced each 35 days at the maximum auction rate, until such time a successful auction occurs. The maximum auction rate is determined based on the lesser of the London Interbank Offered Rate or the Securities Industry and Financial Markets Association Municipal Swap Index rate plus a defined premium. The year-to-date weighted-average interest rate at March 31, 2010 was 0.46% for these bonds.

On March 1, 2010, $50.0 million of PGL's Series MM-2 First and Refunding Mortgage Bonds matured. PGL repaid the outstanding principal balance on these 4.00% bonds, previously subject to terms and conditions of its First Mortgage Indenture dated January 2, 1926, as supplemented. Under the terms of the Indenture, substantially all property owned by PGL is pledged as collateral.

(4) In June 2010, Integrys Energy Group's $65.6 million unsecured term loan will mature. As a result, this loan is included in the current portion of long-term debt on Integrys Energy Group's Condensed Consolidated Balance Sheets at March 31, 2010.

(5) In April 2001, the Schuylkill County Industrial Development Authority issued $27.0 million of Refunding Tax Exempt Bonds. The proceeds from the bonds were loaned to WPS Westwood Generation, LLC, a subsidiary of Integrys Energy Services. This loan is repaid by WPS Westwood Generation to Schuylkill County Industrial Development Authority with monthly interest only payments and has a floating interest rate that is reset weekly. At March 31, 2010, the interest rate was 4.27%. The loan is to be repaid by April 2021. Integrys Energy Group agreed to guarantee WPS Westwood Generation's obligation to provide sufficient funds to pay the loan and the related obligations and indemnities.

At March 31, 2010, Integrys Energy Group and each of its subsidiaries were in compliance with all respective financial covenants related to outstanding long-term debt. Integrys Energy Group's and certain subsidiaries' long-term debt obligations contain covenants related to payment of principal and interest when due and various financial reporting obligations. In addition, certain long-term debt obligations contain financial and other covenants, including but not limited to, a requirement to maintain a debt to total capitalization ratio not to exceed 65%. Failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of outstanding debt obligations.

NOTE 11--ASSET RETIREMENT OBLIGATIONS

The following table shows changes to Integrys Energy Group's asset retirement obligations through March 31, 2010.

(Millions)	Utilities	Integrys Energy Services	Total
Asset retirement obligations at December 31, 2009	$194.8	$0.3 *	$195.1
Accretion	2.9	-	2.9
Asset retirement obligations transferred in sale	-	(0.3)	(0.3)
Asset retirement obligations at March 31, 2010	**$197.7**	**$ -**	**$197.7**

* This amount was classified as held for sale at December 31, 2009, as it was related to the sale of generation assets in Northern Maine, which closed in the first quarter of 2010.

NOTE 12--INCOME TAXES

Integrys Energy Group's effective tax rate for the three months ended March 31, 2010, and 2009, was 50.0% and (7.7)%, respectively.

Integrys Energy Group calculates its provision for income taxes based on an interim effective tax rate that reflects its projected annual effective tax rate before certain discrete items such as the goodwill impairment loss.

The effective tax rate for the three months ended March 31, 2010 was higher than the federal tax rate of 35%, primarily due to the elimination of the deductibility of prescription drug payments to retirees, to the extent those payments will be offset by the receipt of the Medicare Part D subsidy, as mandated in the federal Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010 (HCR). As a result of the legislation, Integrys Energy Group expensed $11.8 million of deferred income tax benefits during the quarter ended March 31, 2010, which were previously recognized as a reduction of provision for income taxes. This additional provision for income taxes will not reoccur in future periods. Also contributing to the higher effective tax rate was the impact of state income taxes.

The effective tax rate for the three months ended March 31, 2009 was lower than the federal tax rate of 35%, primarily because a large portion (approximately $186.2 million) of the $291.1 million goodwill impairment loss recognized in the first quarter of 2009 was not deductible for income tax purposes.

For the three months ended March 31, 2010, there was no significant change in Integrys Energy Group's liability for unrecognized tax benefits.

NOTE 13--COMMITMENTS AND CONTINGENCIES

General

Amounts ultimately paid as penalties, or eventually determined to be paid in lieu of penalties, may not be deductible for income tax purposes.

Commodity Purchase Obligations and Purchase Order Commitments

Integrys Energy Group routinely enters into long-term purchase and sale commitments that have various quantity requirements and durations. The regulated natural gas utilities have obligations to distribute and sell natural gas to their customers, and the regulated electric utilities have obligations to distribute and sell electricity to their customers. The utilities expect to recover costs related to these obligations in future customer rates. Additionally, the majority of the energy supply contracts entered into by Integrys Energy Services are to meet its obligations to deliver energy to customers.

The obligations described below are as of March 31, 2010.

- The electric utility segment has obligations related to coal supply and transportation that extend through 2016 and total $246.6 million, obligations of $1,122.7 million for either capacity or energy related to purchased power that extend through 2027, and obligations for other commodities totaling $9.8 million, which extend through 2013.
- The natural gas utility segment has obligations related to natural gas supply and transportation contracts totaling $1,214.3 million, some of which extend through 2028.
- Integrys Energy Services has obligations related to energy and natural gas supply contracts that extend through 2019 and total $653.7 million. The majority of these obligations end by 2012, with obligations totaling $88.1 million extending beyond 2012.
- Integrys Energy Group also has commitments in the form of purchase orders issued to various vendors, which totaled $405.1 million and relate to normal business operations, including construction projects.

Environmental

Clean Air Act New Source Review Issues

Weston and Pulliam Plants:
On November 18, 2009, the EPA issued a Notice of Violation (NOV) to WPS alleging violations of the New Source Review requirements of the Clean Air Act (CAA). Specifically, the allegations relate to requirements for certain projects undertaken at Pulliam and Weston from 1994 to 2009. WPS has evaluated the NOV, including an analysis of the allegations as well as options for resolution with the EPA and has met with the EPA to discuss a possible resolution. Integrys Energy Group continues to review the allegations but is currently unable to predict the impact on its condensed consolidated financial statements.

Columbia Plant:
On October 10, 2009, WPS, along with its co-owners, received from the Sierra Club a Notice of Intent (NOI) to file a civil lawsuit based on allegations that major modifications were made at the Columbia generation station without complying with the CAA. Specifically, the allegations suggest that Prevention of Significant Deterioration (PSD) permits that imposed Best Available Control Technology (BACT) limits on emissions should have been obtained for the Columbia generation station, which is jointly owned by Wisconsin Power and Light (WP&L), Madison Gas and Electric Company (MG&E), and WPS, and operated by WP&L. The NOI also covers similar allegations related to another generation station solely owned by WP&L. Integrys Energy Group is reviewing the allegations but is currently unable to predict the impact on its condensed consolidated financial statements.

WP&L, on behalf of itself and the joint owners, sent a Notice of Deficiency to the Sierra Club regarding the NOI. In response, the Sierra Club filed a Supplemental NOI on December 14, 2009, purporting to correct the deficiencies. WP&L is in receipt of the Sierra Club's initial demand and is in the process of analyzing the allegations, as well as the demand, and has begun discussions with the Sierra Club.

Edgewater Plant:
On December 11, 2009, WPS, along with its co-owners, received from the Sierra Club a copy of an NOI to file a civil lawsuit against the EPA based on the EPA's failure to take actions against the co-owners and operator of the Edgewater generation station based upon allegations of failure to comply with the CAA. Specifically, the allegations suggest that PSD permits that imposed BACT limits on emissions from the facilities should have been obtained for Edgewater. Edgewater is jointly owned by WP&L, WE Energies (Unit 5) and WPS (Unit 4), and operated by WP&L. WP&L is in the process of analyzing the Sierra Club's actions. Integrys Energy Group is reviewing the allegations but is currently unable to predict the impact on its condensed consolidated financial statements.

On December 21, 2009, WPS, along with its co-owners, received from the Sierra Club an NOI to file a civil lawsuit based on allegations that major modifications were made at the Edgewater generation station without complying with the PSD and Title V Operating Permit requirements of the CAA. Specifically, the allegations suggest that PSD permits that imposed BACT limits on emissions from the facilities should have been obtained for Edgewater. WP&L is in the process of analyzing the allegations and has begun discussions with the Sierra Club. Integrys Energy Group is reviewing the allegations but is currently unable to predict the impact on its condensed consolidated financial statements.

Columbia and Edgewater Plants:
On December 14, 2009, the EPA issued an NOV to WP&L relative to its Nelson Dewey Plant and to WP&L and the other joint owners of the Columbia and Edgewater generation stations alleging violations of New Source Review requirements of the CAA for certain projects undertaken at those plants. The joint owners met with the EPA to begin discussions on a possible resolution and have received the EPA's initial demand. WP&L is the operator of these plants and, along with the joint owners, is in the process of analyzing the NOV and the EPA's initial demand. Integrys Energy Group is also reviewing the allegations but is currently unable to predict the impact on its condensed consolidated financial statements.

EPA Settlements with Other Utilities:
In response to the EPA's CAA enforcement initiative, several utilities elected to settle with the EPA, while others are in litigation. The fines and penalties (including the cost of supplemental environmental projects) associated with settlements involving comparably-sized facilities to Weston and Pulliam range between $7 million and $30 million. The regulatory interpretations upon which the lawsuits or settlements are based may change based on future court decisions made in the pending litigation.

If the EPA brings a claim against WPS, and if it were determined by a court that historic projects at WPS's Pulliam and Weston plants required either a state or federal CAA permit, WPS may, under the applicable statutes, be required, in order to resolve any such claim, to:

- shut down any unit found to be operating in non-compliance,
- install additional pollution control equipment and/or impose emission limitations,
- pay a fine, and/or
- conduct a supplemental environmental project.

In addition, under the CAA, citizen groups may pursue a claim. Except as noted above for the Columbia and Edgewater plants, WPS has no notice of such a claim.

Weston Air Permits

In November 2004, the Sierra Club filed a petition with the WDNR under Section 285.61 of the Wisconsin Statutes seeking a contested case hearing on the construction permit issued for the Weston 4 generation station, which was a necessary predicate to plant construction under the pertinent air emission regulations (hereinafter referred to as the "Weston 4 air permit"). In February 2006, the administrative law judge affirmed the Weston 4 air permit with changes to the emission limits for sulfur dioxide and nitrogen oxide from the coal-fired boiler and particulate from the cooling tower. The changes, which were implemented by the WDNR in a revised permit issued on March 28, 2007, set limits that were more stringent than those originally set by the WDNR (hereinafter referred to as the "March 28, 2007 permit language").

On April 27, 2007, the Sierra Club filed a second petition requesting a contested case hearing regarding the March 28, 2007 permit language, which was granted by the WDNR. Both parties subsequently moved for summary judgment. In a decision issued on November 8, 2007, the administrative law judge granted WPS's motion for summary judgment in that proceeding, upholding the March 28, 2007 permit language. The Sierra Club filed petitions with the Dane County Circuit Court on April 27, 2007, and November 14, 2007, for judicial review of the Weston 4 air permit and the underlying proceedings before the administrative law judge. These two judicial review proceedings were consolidated by the court. On February 12, 2009, the court upheld the administrative law judge's final order, which affirmed the WDNR's actions. The Sierra Club appealed this decision and the parties have completed filing briefs and are awaiting the appellate court's decision.

These activities did not stay the construction and startup of the Weston 4 facility or the administrative law judge's decision on the Weston 4 air permit. WPS believes that it has substantial defenses to the Sierra Club's challenges. Until the Sierra Club's challenges are finally resolved, Integrys Energy Group will not be able to make a final determination of the probable cost impact, if any, of compliance with any changes to the Weston 4 air permit on its future costs.

In December 2008, an NOV was issued to WPS by the WDNR alleging various violations of the air permits for Weston 4, as well as Weston 1 and 2. The alleged violations include an exceedance of the carbon monoxide and volatile organic compound limits at Weston 4, exceedances of the hourly sulfur dioxide limit in ten three-hour periods during startup/shutdown and during one separate event at Weston 4, and two that address baghouse operation at Weston 1 and 2. On July 22, 2009, an NOV was issued to WPS by the WDNR alleging violations of the opacity limits during two six-minute periods (one each at Weston 2 and 4) and of the sulfur dioxide average limit during one three-hour period at Weston 4. An NOV was issued to WPS in September 2009 relating to one event involving baghouse operation at Weston 1 and 2 that occurred in December 2008. A fourth NOV was issued on December 14, 2009, for a clerical error involving pages missing from a quarterly report. Corrective actions have been taken for the events in the four NOVs. An enforcement conference was held on January 7, 2009, for the December 2008 NOV and on August 26, 2009, for the July 2009 NOV. Discussions with the WDNR on the severity classification of the events continue. Management believes it is likely that the WDNR will refer the NOVs to the state Justice Department for enforcement. Management does not believe that these matters will have a material adverse impact on the condensed consolidated financial statements of Integrys Energy Group.

In early November 2006, it came to the attention of WPS that previous ambient air quality computer modeling done by the WDNR for the Weston facility (and other nearby air sources) did not take into account the emissions from the existing Weston 3 facility for purposes of evaluating air quality increment consumption under the required PSD. WPS believes it has undertaken and completed corrective measures to address any identified modeling issues and anticipates issuance of a revised Title V permit that will resolve this issue. Integrys Energy Group currently is not able to make a final determination of the probable cost impact of this issue, if any.

Columbia Air Permit

The renewal of the Title V air permit for the Columbia generation station, jointly owned by WP&L, MG&E, and WPS and operated by WP&L, was issued by the WDNR on September 2, 2008. On October 8, 2009, the EPA issued an order objecting to the Title V air permit. The order responds to a petition filed by the Sierra Club and determined that a project in 2006 to replace the economizer, final superheater, and related components on Unit 1 should have been permitted as a "major modification." The order directs the WDNR to resolve the EPA's objections within 90 days and "terminate, modify, or revoke and reissue" the Title V permit accordingly. As of March 22, 2010, the WDNR has reopened the permit to address the EPA's order and, although final resolution is unknown, potential outcomes could include a revised permit.

Mercury and Interstate Air Quality Rules

Mercury

The State of Wisconsin's mercury rule, Chapter NR 446, requires a 40% reduction from the 2002 through 2004 baseline mercury emissions in Phase I, beginning January 1, 2010, through the end of 2014. In Phase II, which begins in 2015, electric generating units above 150 megawatts will be required to reduce mercury emissions by 90%. Reductions can be phased in and the 90% target can be delayed until 2021 if additional sulfur dioxide and nitrogen oxide reductions are implemented. By 2015, electric generating units above 25 megawatts but less than 150 megawatts must reduce their mercury emissions to a level defined by the BACT rule. As of March 31, 2010, WPS estimates capital costs of approximately $19 million for Phase I and Phase II, which includes estimates for both wholly owned and jointly owned plants, to achieve the required reductions. The capital costs are expected to be recovered in future rate cases. Because of the vacatur of the federal mercury control and monitoring rule in February 2008, the EPA is reviewing options for a new rulemaking to address hazardous air pollutants, including mercury, and is expected to issue a draft rule in 2011.

Sulfur Dioxide and Nitrogen Oxide

The EPA issued the Clean Air Interstate Rule (CAIR) in 2005. CAIR was originally intended to reduce sulfur dioxide and nitrogen oxide emissions from utility boilers located in 29 states, including Wisconsin, Michigan, Pennsylvania, and New York. The first phase of CAIR required about a 50% reduction beginning in 2009 for nitrogen oxide and beginning in 2010 for sulfur dioxide. The second phase required about a 65% reduction in emissions of both pollutants by 2015. The State of Wisconsin's rule to implement CAIR, which incorporates the cap and trade approach, has been forwarded to the EPA for final review.

On July 11, 2008, the Court of Appeals issued a decision vacating CAIR, the EPA appealed, and in December 2008, the Court of Appeals reversed the CAIR vacatur and CAIR was reinstated. The Court of Appeals directed the EPA to address the deficiencies noted in its July 11, 2008 ruling, and the EPA has indicated they expect to issue a draft revised CAIR rule for comment in 2010. As a result of the Court of Appeals' decision, CAIR is in place for 2010. WPS has not acquired any nitrogen oxide allowances for vintage years beyond 2010 other than those allocated by the EPA and does not expect any material impact as a result of the vacatur and subsequent reinstatement of CAIR.

The reinstatement of CAIR also affected the status of the Best Available Retrofit Technology (BART) rule, which is a rule that addresses regional haze and visibility. The WDNR is evaluating whether air quality improvements under CAIR will be adequate to demonstrate compliance with BART.

For planning purposes, it is still assumed that additional sulfur dioxide and nitrogen oxide controls will be needed on existing units. The installation of any controls will need to be scheduled as part of WPS's long-term maintenance plan for its existing units. As such, controls may need to be installed before 2015. On a preliminary basis, and assuming controls are still required, WPS estimates capital costs of $596 million, which includes estimates for both wholly owned and WPS's share of jointly owned plants, in order to meet an assumed 2015 compliance date. This estimate is based on costs of current control technology and current information regarding the final state and federal rules. The capital costs are anticipated to be recovered in future rate cases.

Manufactured Gas Plant Remediation

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. In connection with manufacturing and storing manufactured gas, waste materials were produced that may have resulted in soil and groundwater contamination at these sites. Under certain laws and regulations relating to the protection of the environment, Integrys Energy Group's natural gas utilities are required to undertake remedial action with respect to some of these materials.

Integrys Energy Group's natural gas utilities are responsible for the environmental impacts at 55 manufactured gas plant sites located in Wisconsin, Michigan, and Illinois. All are former regulated utility sites and are being remediated, with costs charged to existing ratepayers at WPS, MGU, PGL, and NSG. Twenty of these sites have been transferred to the EPA Superfund Alternative Sites Program. Under the EPA's program, the remedy decisions at these sites will be based on risk-based criteria typically used at Superfund sites. Integrys Energy Group estimated and accrued for $655.5 million of future undiscounted investigation and cleanup costs for all sites as of March 31, 2010. Integrys Energy Group may adjust these estimates in the future, contingent upon remedial technology, regulatory requirements, remedy determinations, and any claims of natural resource damages. Integrys Energy Group recorded a regulatory asset of $666.0 million, which is net of insurance recoveries received of $56.9 million, related to the expected recovery of both deferred expenditures and estimated future expenditures as of March 31, 2010.

Integrys Energy Group's natural gas utilities are coordinating the investigation and cleanup of the manufactured gas plant sites subject to EPA jurisdiction under what is called a "multi-site" program. This program involves prioritizing the work to be done at the sites, preparation and approval of documents common to all of the sites, and utilization of a consistent approach in selecting remedies.

The EPA identified NSG as a potentially responsible party (PRP) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), at the Waukegan Coke Plant Site located in Waukegan, Illinois (Waukegan Site). The Waukegan Site is part of the Outboard Marine Corporation (OMC) Superfund Site. The EPA also identified OMC, General Motors Corporation (GM), and certain other parties as PRPs at the Waukegan Site. NSG and the other PRPs are parties to a consent decree that requires NSG and GM, jointly and severally, to perform the remedial action and establish and maintain financial assurance of $27.0 million. The EPA reduced the financial assurance requirement to $21.0 million to reflect completion of the soil component of the remedial action in August 2005. NSG has met its financial assurance requirement in the form of a net worth test while GM met the requirement by providing a performance and payment bond in favor of the EPA. As a result of the GM bankruptcy filing, the EPA has contacted the surety and the surety has stated that it will provide the EPA access to the surety bond funds which are expected to fund a significant portion of GM's liability. The potential exposure related to the GM bankruptcy that is not expected to be covered by the bond proceeds has been reflected in the accrual identified above.

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. Accordingly, management believes that the costs incurred in connection with former manufactured gas plant operations will not have a material adverse effect on the condensed consolidated financial statements of Integrys Energy Group.

Greenhouse Gases

Integrys Energy Group is evaluating both the technical and cost implications that may result from future state, regional, or federal greenhouse gas regulatory programs. This evaluation indicates it is probable that any regulatory program which caps emissions or imposes a carbon tax will increase costs for Integrys Energy Group and its customers. The greatest impact is likely to be on fossil fuel-fired generation, with a less significant impact on natural gas storage and distribution operations. Efforts are underway within the utility industry to find a feasible method for capturing carbon dioxide from pulverized coal-fired units and to develop cleaner ways to burn coal. The use of alternate fuels is also being explored by the industry, but there are many cost and availability issues. 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, and the Kerry-Boxer draft bill, which was introduced in the United States Senate. 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 CAA. 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.

Escanaba Water Permit Issues

UPPCO operates the Escanaba Generating Station (EGS) under contract with its owner, the City of Escanaba (City). While the City owns the water permits for EGS, UPPCO's personnel provide testing and certification of waste water discharges. In September 2008, UPPCO became aware of potential water discharge permit violations regarding reported pH and oil and grease readings at EGS. Corrective actions were implemented at the plant, notification was provided to the City, and UPPCO self reported the potential permit violations to the Michigan Department of Environmental Quality (MDEQ). UPPCO filed a final report with the MDEQ on November 25, 2008, and a copy was sent to the City.

In March 2009, MDEQ began its investigation into this matter. Depending upon the results of the MDEQ's review of the information provided by UPPCO, the MDEQ, in consultation with the Michigan Attorney General's Office, may assess a fine and/or seek criminal charges against UPPCO, assess a fine and/or seek criminal charges against the former manager who certified the reports, and/or close out the investigation. In October 2009, the matter was referred to the Delta County District Attorney's office for potential criminal charges against the former manager. No charges have been brought against UPPCO as of this time, however it is unknown if a referral will be made relative to the company. Although a specific date of resolution is unknown, UPPCO has responded to all information requests from the MDEQ.

Natural Gas Charge Reconciliation Proceedings and Related Matters

Natural Gas Charge Settlement and Pending Natural Gas Charge Cases

For PGL and NSG, the ICC conducts annual proceedings regarding the reconciliation of revenues from the natural gas charge and related natural gas costs. The natural gas charge represents the cost of natural gas and transportation and storage services purchased by PGL and NSG, as well as gains, losses, and costs incurred under PGL's and NSG's hedging program (Gas Charge). In these proceedings, interested parties review the accuracy of the reconciliation of revenues and costs and the prudence of natural gas costs recovered through the Gas Charge. If the ICC were to find that the reconciliation was inaccurate or any natural gas costs were imprudently incurred, the ICC would order PGL and NSG to refund the affected amount to customers through subsequent Gas Charge filings.

In March 28, 2006 orders, the ICC adopted a settlement agreement related to fiscal years 2001 through 2004 natural gas costs. Under certain provisions of the settlement agreement, PEC agreed to provide the Illinois Attorney General (AG) and the City of Chicago (Chicago) up to $30.0 million for conservation and weatherization programs for which PGL and NSG may not seek rate recovery. The balance of the conservation and weatherization funding that remained unpaid as of March 31, 2010, was $10.2 million, of which $5.2 million was included in other current liabilities, and $5.0 million was included in other long-term liabilities. PEC also agreed to implement a reconnection program for certain customers. PGL and NSG took all steps required by the settlement agreement with respect to the reconnection program. In April 2010, PGL, NSG, the AG, the Citizens Utility Board, and Chicago resolved a disagreement concerning the scope of the reconnection program. Finally, PEC agreed to internal audits and an external audit of natural gas supply practices. Four of the five annual internal audits required by the settlement agreement have been completed. An auditor hired by the ICC conducted the external audit and filed its report on April 10, 2008. On March 31, 2009, PGL and NSG completed their responses to the external auditor's recommendations.

The fiscal 2006 Gas Charge reconciliation cases were initiated on November 21, 2006. The ICC staff and interveners (the AG, the Citizens Utility Board, and Chicago, filing jointly) each filed testimony recommending disallowances for PGL and NSG for a bank natural gas adjustment similar to that addressed in the fiscal 2005 Gas Charge reconciliation cases, which PGL and NSG did not contest. In addition, the interveners recommended a disallowance for PGL of $13.9 million (reduced to $11.0 million in their brief) associated with PGL's provision of interstate hub services. The ICC staff does not support the interveners' proposal, and PGL does not believe the proposal has merit. A hearing for the PGL and NSG cases was held on December 11, 2008. For PGL, briefing concluded February 27, 2009, and the administrative law judge has not yet prepared a proposed order. For NSG, there were no contested issues, and the parties filed an agreed form of order in January 2009.

Reconciliations of subsequent periods have been opened but are being held in abeyance pending the outcome of the fiscal 2006 Gas Charge reconciliation cases.

Class Action

In February 2004, a purported class action suit was filed in Cook County Circuit Court against PEC, PGL, and NSG by customers of PGL and NSG, alleging among other things, violation of the Illinois Consumer Fraud and Deceptive Business Practices Act related to matters at issue in the utilities' fiscal year 2001 Gas Charge reconciliation proceedings. In the suit, Alport et al. v. Peoples Energy Corporation, the plaintiffs seek disgorgement and punitive damages. PGL and NSG have been dismissed as defendants and the only remaining counts of the suit allege violations of the Consumer Fraud and Deceptive Business Practices Act by PEC and that PEC acted in concert with others to commit a tortious act. PEC denies the allegations and is vigorously defending the suit. On November 19, 2009, the court entered an order certifying a class composed of customers of PGL and NSG during the period April 26, 2000, through September 30, 2002. On March 26, 2010, PEC filed a Petition for Leave to Appeal to the Illinois Supreme Court challenging class certification and the petition is currently pending.

NOTE 14--GUARANTEES

The following table shows outstanding guarantees at Integrys Energy Group:

		Expiration			
(Millions)	**Total Amounts Committed at March 31, 2010**	**Less Than 1 Year**	**1 to 3 Years**	**4 to 5 Years**	**Over 5 Years**
Guarantees supporting commodity transactions of subsidiaries [1]	**$1,107.8**	$ 776.9	$ 62.7	$31.0	$237.2
Standby letters of credit [2]	**332.9**	331.0	1.8	0.1	-
Surety bonds [3]	**3.3**	3.1	0.2	-	-
Other guarantees [4]	**56.2**	-	50.0	-	6.2
Total guarantees	**$1,500.2**	$1,111.0	$114.7	$31.1	$243.4

[1] Consists of parental guarantees of $927.2 million to support the business operations of Integrys Energy Services; $100.2 million and $70.4 million, respectively, related to natural gas supply at MERC and MGU; and

$5.0 million at both PEC and IBS to support business operations. These guarantees are not reflected on the Condensed Consolidated Balance Sheets.

(2) Composed of $322.4 million issued to support Integrys Energy Services' operations; $4.8 million related to letters of credit at WPS; $4.3 million issued for workers compensation coverage in Illinois; and $1.4 million related to letters of credit at UPPCO, MGU, MERC, PGL, and NSG. These amounts are not reflected on the Condensed Consolidated Balance Sheets.

(3) Primarily for workers compensation coverage and obtaining various licenses, permits, and rights of way. Surety bonds are not included on the Condensed Consolidated Balance Sheets.

(4) Consists of (1) $50.0 million related to the sale agreement for Integrys Energy Services' United States wholesale electric marketing and trading business, which included a number of customary representations, warranties, and indemnification provisions. In addition, for a two-year period, counterparty payment default risk was retained with approximately 50% of the counterparties associated with the commodity contracts transferred in this transaction. A $0.8 million liability was recorded related to the fair value of this counterparty payment default risk; (2) a $5.0 million environmental indemnification provided by Integrys Energy Services related to the sale of the Stoneman generation facility, under which Integrys Energy Group expects that the likelihood of required performance is remote; and (3) $1.2 million related to other indemnifications and workers compensation coverage.

Integrys Energy Group has provided total parental guarantees of $1,334.0 million on behalf of Integrys Energy Services as shown in the table below. Integrys Energy Group's exposure under these guarantees (excluding exposure secured by standby letters of credit) related to open transactions at March 31, 2010, was approximately $548 million.

(Millions)	March 31, 2010
Guarantees supporting commodity transactions	$927.2
Standby letters of credit	322.4
Guarantees of subsidiary debt *	27.0
Surety bonds	1.7
Other	55.7
Total guarantees	**$1,334.0**

* Consists of outstanding debt at an Integrys Energy Services subsidiary, which is not included in the total Integrys Energy Group guarantee amounts above, because the debt is reflected on the Condensed Consolidated Balance Sheets.

NOTE 15--EMPLOYEE BENEFIT PLANS

The following table shows the components of net periodic benefit cost for Integrys Energy Group's benefit plans for the three months ended March 31:

	Pension Benefits		Other Benefits	
(Millions)	2010	2009	2010	2009
Service cost	$10.9	$ 9.3	$4.5	$3.7
Interest cost	20.6	19.8	7.1	7.1
Expected return on plan assets	(22.3)	(23.2)	(4.7)	(4.4)
Amortization of transition obligation	-	-	0.1	0.1
Amortization of prior service cost (credit)	1.3	1.2	(1.0)	(1.0)
Amortization of net actuarial loss	2.9	0.2	0.7	0.3
Amortization of merger related regulatory adjustment (1)	-	2.8	-	0.5
Regulatory deferral (2)	1.1	(0.8)	(0.3)	(0.4)
Net periodic benefit cost	$14.5	$ 9.3	$6.4	$5.9

(1) Effective with the 2010 rate order, PGL and NSG reflect pension and other postretirement benefit costs in rates using Integrys Energy Group's accounting basis, which was established at the time of the February 2007 PEC merger. As a result, the merger related regulatory adjustment was eliminated. Pursuant to the 2010 rate order,

a new regulatory asset was established for the remaining cumulative difference that existed between the accounting bases of PGL/NSG and Integrys Energy Group in the pension and other postretirement benefit obligations. The amortization of this regulatory asset over the average remaining service lives of the participating employees is not included as a component of net periodic benefit cost.

(2) The PSCW authorized WPS to recover its net increased 2009 pension costs and to refund its net decreased 2009 other postretirement benefit costs as part of the limited rate case re-opener for 2010. Amortization and recovery/refund of these costs will occur throughout 2010.

Transition obligations, prior service costs (credits), and net actuarial losses that have not yet been recognized as a component of net periodic benefit cost are included in accumulated OCI for Integrys Energy Group's nonregulated entities and are recorded as net regulatory assets for the utilities.

Contributions to the plans are made in accordance with legal and tax requirements and do not necessarily occur evenly throughout the year. For the three months ended March 31, 2010, contributions made to the pension and other postretirement benefit plans were not significant. Integrys Energy Group expects to contribute $66.4 million to its pension plans and $35.7 million to its other postretirement benefit plans during the remainder of 2010.

NOTE 16--STOCK-BASED COMPENSATION

Stock Options

Compensation cost recognized for stock options during the three months ended March 31, 2010, and 2009, was not significant. As of March 31, 2010, $2.4 million of compensation cost related to unvested and outstanding stock options was expected to be recognized over a weighted-average period of 3.2 years.

Cash received from option exercises during the three months ended March 31, 2010, was $9.6 million. The tax benefit realized from these option exercises was $3.9 million.

A summary of stock option activity for the three months ended March 31, 2010, and information related to outstanding and exercisable stock options at March 31, 2010, is presented below:

	Stock Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life *(In Years)*	Aggregate Intrinsic Value *(Millions)*
Outstanding at December 31, 2009	3,133,286	$47.06		
Granted	554,092	41.58		
Exercised	259,926	36.93		$2.7
Forfeited	39,906	47.03		0.1
Expired	58,249	49.68		-
Outstanding at March 31, 2010	**3,329,297**	**$46.90**	**6.72**	**$8.7**
Exercisable at March 31, 2010	**1,954,161**	**$48.34**	**5.34**	**$3.5**

The aggregate intrinsic value for outstanding and exercisable options in the above table represents the total pre-tax intrinsic value that would have been received by the option holders had they all exercised their options at March 31, 2010. This is calculated as the difference between Integrys Energy Group's closing stock price on March 31, 2010, and the option exercise price, multiplied by the number of in-the-money stock options.

Performance Stock Rights

Compensation cost recorded for performance stock rights during the three months ended March 31, 2010, and 2009, was not significant. As of March 31, 2010, $6.4 million of compensation cost related to unvested and outstanding performance stock rights was expected to be recognized over a weighted-average period of 2.5 years.

A summary of the activity related to performance stock rights for the three months ended March 31, 2010, is presented below:

	Performance Stock Rights	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2009	301,090	$46.33
Granted	150,481	42.45
Distributed	45,847	53.29
Expired	26,009	53.45
Forfeited	37,849	42.54
Outstanding at March 31, 2010	**341,866**	**$42.69**

Restricted Shares and Restricted Share Units

The fair value of restricted share units granted in 2010 was based on Integrys Energy Group's closing stock price on the grant date.

Compensation cost recognized for these awards during the three months ended March 31, 2010, and 2009, was not significant. As of March 31, 2010, $11.8 million of compensation cost related to these awards was expected to be recognized over a weighted-average period of 3.0 years.

A summary of the activity related to restricted share and restricted share unit awards for the three months ended March 31, 2010, is presented below:

	Restricted Shares and Restricted Share Unit Awards	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2009	346,858	$45.55
Granted	209,252	41.64
Distributed	88,341	45.37
Forfeited	29,094	44.10
Outstanding at March 31, 2010	**438,675**	**$43.82**

NOTE 17–COMPREHENSIVE INCOME (LOSS)

Integrys Energy Group's total comprehensive income (loss) was as follows:

	Three Months Ended March 31	
(Millions)	**2010**	**2009**
Net income (loss) attributed to common shareholders	**$49.5**	$(180.2)
Cash flow hedges, net of tax *	**(12.4)**	(30.7)
Foreign currency translation, net of tax	**0.8**	(0.5)
Amortizations of unrecognized pension and other postretirement benefit costs, net of tax	**0.5**	(0.2)
Total comprehensive income (loss)	**$38.4**	$(211.6)

* For the three months ended March 31, 2010, and 2009, the tax benefit was $5.7 million and $20.2 million, respectively.

The following table shows the changes to Integrys Energy Group's accumulated other comprehensive loss from December 31, 2009, to March 31, 2010.

(Millions)	Three Months Ended March 31, 2010
December 31, 2009 balance	$(44.0)
Cash flow hedges	(12.4)
Foreign currency translation	0.8
Amortizations of unrecognized pension and other postretirement benefit costs	0.5
March 31, 2010 balance	**$(55.1)**

NOTE 18--COMMON EQUITY

Integrys Energy Group's reconciliation of shares outstanding was as follows:

	March 31, 2010		December 31, 2009	
	Shares	Average Cost	Shares	Average Cost
Common stock issued	**76,806,208**		76,418,843	
Less:				
Deferred compensation rabbi trust	**368,813**	**$42.57** [1]	402,839	$42.58 [1]
Restricted stock	**29,573**	**$55.06** [2]	35,861	$55.33 [2]
Total shares outstanding	**76,407,822**		75,980,143	

[1] Based on Integrys Energy Group's stock price on the day the shares entered the deferred compensation rabbi trust. Shares paid out of the trust are valued at the average cost of shares in the trust.

[2] Based on the grant date fair value of the restricted stock.

Beginning February 11, 2010, Integrys Energy Group issued new shares of common stock to meet the requirements of its Stock Investment Plan and certain stock-based employee benefit and compensation plans. From January 1, 2010 to February 11, 2010, and during 2009, Integrys Energy Group purchased shares of its common stock on the open market to meet the requirements of these plans.

Integrys Energy Group had the following changes to issued common stock during the three months ended March 31, 2010:

Integrys Energy Group's common stock shares	
Common stock at December 31, 2009	76,418,843
Shares issued	
Stock Investment Plan	172,251
Stock-based compensation	219,367
Restricted stock shares retired	(4,253)
Common stock at March 31, 2010	**76,806,208**

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) attributed to common shareholders by the weighted average number of common stock shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) attributed to common shareholders by the weighted average number of common stock shares outstanding during the period, adjusted for the exercise and/or conversion of all potentially dilutive securities. Such dilutive items include in-the-money stock options, performance stock rights, and restricted stock. The calculation of diluted earnings per share for the three months ended March 31, 2010, excluded 1.8 million out-of-the-money stock options that had an anti-dilutive effect. The effects of an insignificant number of in-the-money securities were not included in the computation for the three months ended March 31, 2009, because there was a net loss during the period, which would cause the impact to be anti-dilutive. The calculation of diluted earnings per share for the three months ended March 31, 2009 also excluded 3.2 million out-of-the-money stock options that had an anti-dilutive effect. The following table reconciles the computation of basic and diluted earnings (loss) per share:

	Three Months Ended March 31	
(Millions, except per share amounts)	2010	2009
Numerator:		
Net income (loss) from continuing operations	**$50.2**	$(179.5)
Discontinued operations, net of tax	**0.1**	-
Preferred stock dividends of subsidiary	**(0.8)**	(0.8)
Noncontrolling interest in subsidiaries	**-**	0.1
Net income (loss) attributed to common shareholders	**$49.5**	$(180.2)
Denominator:		
Average shares of common stock – basic	**76.9**	76.7
Effect of dilutive securities		
Stock-based compensation	**0.3**	-
Average shares of common stock – diluted	**77.2**	76.7
Earnings (loss) per common share		
Basic	**$0.64**	$(2.35)
Diluted	**0.64**	(2.35)

NOTE 19–VARIABLE INTEREST ENTITIES

Effective January 1, 2010, Integrys Energy Group implemented SFAS No. 167, "Amendments to FASB Interpretation No. 46 (R)" (now incorporated as part of the Consolidation Topic of the FASB ASC). Integrys Energy Group has variable interests in two entities through power purchase agreements relating to the cost of fuel. In these cases, Integrys Energy Group has considered which interest holder has the power to direct the activities that most significantly impact the economics of the variable interest entity; this interest holder is considered the primary beneficiary of the entity and is required to consolidate the entity. For a variety of reasons, including the length of the remaining term of the contracts compared with the remaining lives of the plants and the fact that Integrys Energy Group does not have the power to direct the operations of the facilities, Integrys Energy Group has determined it is not the primary beneficiary of these variable interest entities.

As of March 31, 2010, the carrying amount of assets and liabilities on the Condensed Consolidated Balance Sheets that relate to the involvement with these variable interest entities are related to working capital accounts and represent the amounts owed by Integrys Energy Group for the current deliveries of power. Integrys Energy Group has not provided or guaranteed any debt or equity support, liquidity arrangements, performance guarantees or other commitments associated with these contracts. There is no significant potential exposure to loss as a result of its involvement with the variable interest entities.

In 2008, Integrys Energy Group contributed certain assets to LGS Renewables I, L.C. in exchange for a 50% interest in the entity. Simultaneously, Integrys Energy Group entered into a loan agreement with LGS Renewables I, L.C. to finance the development and construction of a pipeline project to provide landfill gas to a customer. Integrys Energy Group determined at the time that the entity is a variable interest entity and that Integrys Energy Group is the primary beneficiary of the entity. Integrys Energy Group updated its conclusion upon implementation of the new standard and continued to conclude that Integrys Energy Group is the primary beneficiary. Therefore, Integrys Energy Group's condensed consolidated financial statements include the results of LGS Renewables I, L.C.

At March 31, 2010, Integrys Energy Group's variable interests in LGS include its equity investment and loans of $24.9 million. Integrys Energy Group's maximum exposure to loss as a result of this partnership is equal to advances under the loan agreement. Its equity investment is insignificant.

The carrying amounts and classifications of the above consolidated variable interest entity assets and liabilities included in Integrys Energy Group condensed consolidated financial statements were:

(Millions)	**March 31, 2010**	December 31, 2009
Current assets	**$1.5**	$0.8
Property, plant and equipment	**16.8**	17.1
Other long-term assets	**4.9**	4.8
Total assets	**$23.2**	$22.7
Current notes payable to affiliates	**$2.4**	$2.0
Other current liabilities	**0.4**	0.5
Notes payable to affiliates	**22.5**	22.2
Total equity	**(2.1)**	(2.0)
Total liabilities and equity	**$23.2**	$22.7

NOTE 20--FAIR VALUE

Fair Value Measurements

In the three months ended March 31, 2010, Integrys Energy Group identified additional classes of risk management assets and liabilities as a result of the implementation of FASB Accounting Standards Update (ASU) 2010-06, "Fair Value Measurements and Disclosures (Topic 820), Improving Disclosures about Fair Value Measurements." As required, this ASU was only applied for the quarter ended March 31, 2010, and therefore, prior periods do not reflect the expanded disclosure requirements.

The following tables show Integrys Energy Group's assets and liabilities that were accounted for at fair value on a recurring basis, categorized by level within the fair value hierarchy.

(Millions)	March 31, 2010 Level 1	Level 2	Level 3	Total
Assets				
Risk Management Assets				
Utility Segments				
Financial transmission rights	$ -	$ -	$ 1.9	$ 1.9
Natural gas contracts	0.1	1.2	-	1.3
Petroleum product contracts	0.2	-	-	0.2
Nonregulated Segments				
Natural gas contracts	74.3	162.4	45.3	282.0
Power contracts	34.7	375.2	234.2	644.1
Interest rate swaps	-	1.9	-	1.9
Foreign exchange contracts	0.1	1.7	-	1.8
Total Risk Management Assets	109.4	542.4	281.4	933.2
Other Assets	0.1	-	-	0.1
Liabilities				
Risk Management Liabilities				
Utility Segments				
Financial transmission rights	-	-	0.4	0.4
Natural gas contracts	2.6	51.7	-	54.3
Nonregulated Segments				
Natural gas contracts	74.8	198.7	8.5	282.0
Power contracts	60.0	435.6	366.5	862.1
Interest rate swaps	-	4.3	-	4.3
Foreign exchange contracts	1.7	0.1	-	1.8
Total Risk Management Liabilities	139.1	690.4	375.4	1,204.9
Long-term debt hedged by fair value hedge	-	51.9	-	51.9

(Millions)	December 31, 2009 Level 1	Level 2	Level 3	Total
Assets				
Risk management assets	$284.9	$439.6	$1,593.0	$2,317.5
Other	0.1	-	-	0.1
Liabilities				
Risk management liabilities	336.4	582.2	1,471.6	2,390.2
Long-term debt hedged by fair value hedge	-	52.6	-	52.6

Integrys Energy Group determined the fair values above using a market based approach that incorporates observable market inputs where available, and internally developed inputs where observable market data is not readily available. For the unobservable inputs, consideration is given to the assumptions that market participants would use in valuing the asset or liability. These factors include not only the credit standing of the counterparties involved, but also the impact of Integrys Energy Group's nonperformance risk on its liabilities.

The risk management assets and liabilities listed in the tables include options, swaps, futures, physical commodity contracts, and other instruments used to manage market risks related to changes in commodity prices and interest rates. For more information on Integrys Energy Group's derivative instruments, see Note 3, "*Risk Management Activities.*"

When possible, Integrys Energy Group bases the valuations of its risk management assets and liabilities on quoted prices for identical assets in active markets. These valuations are classified in Level 1. The valuations of certain contracts include inputs related to market price risk (commodity or interest rate), price volatility (for option contracts), price correlation (for cross commodity contracts), credit risk, and time value. These inputs are available through multiple sources, including brokers and over-the-counter and online exchanges. Transactions valued using these inputs are classified in Level 2.

Certain derivatives are categorized in Level 3 due to the significance of unobservable or internally-developed inputs. The primary reasons for a Level 3 classification are as follows:

- While price curves may have been based on observable information, significant assumptions may have been made regarding seasonal or monthly shaping and locational basis differentials.
- Certain transactions were valued using price curves that extended beyond the quoted period. Assumptions were made to extrapolate prices from the last quoted period through the end of the transaction term, primarily through use of historically settled data or using correlations to other locations.

Integrys Energy Group recognizes transfers between the levels of the fair value hierarchy at the end of the reporting period.

The following table shows the transfers between the levels of the fair value hierarchy during the three months ended March 31, 2010. All the transfers that occurred during the period related to power contracts in the nonregulated segment.

(Millions)	Level 1	Level 2	Level 3
Transfers into Level 1 from	N/A	$(9.9)	$(14.3)
Transfers into Level 2 from	$ -	N/A	$23.2
Transfers into Level 3 from	$ -	$(4.4)	N/A

Derivatives are transferred in or out of Level 3 primarily due to changes in the source of data used to construct price curves as a result of changes in market liquidity.

The following tables set forth a reconciliation of changes in the fair value of items categorized as Level 3 measurements:

Three Months Ended March 31, 2010	Nonregulated Segments		Utility Segments	
(Millions)	Natural gas	Power	Financial transmission rights	Total
Balance at the beginning of the period	$31.4	$ 86.5	$3.5	$121.4
Net realized and unrealized gain (loss) included in earnings	17.2	(94.8)	(0.1)	(77.7)
Net realized loss recorded as regulatory assets or liabilities	-	-	(2.0)	(2.0)
Net unrealized loss included in other comprehensive loss	-	(13.2)	-	(13.2)
Net purchases and settlements	(11.8)	(97.5)	0.1	(109.2)
Net transfers into Level 3	-	(4.4)		(4.4)
Net transfers out of Level 3	-	(8.9)	-	(8.9)
Balance at the end of the period	36.8	(132.3)	1.5	(94.0)
Net unrealized gain (loss) included in earnings related to instruments still held at the end of the period	17.2	(94.8)	-	(77.6)

Three Months Ended March 31, 2009 *(Millions)*	
Balance at the beginning of period	$162.0
Net realized and unrealized gain included in earnings	73.2
Net unrealized loss recorded as regulatory assets or liabilities	(0.1)
Net unrealized loss included in other comprehensive loss	(18.0)
Net purchases and settlements	(18.0)
Net transfers in/out of Level 3	(87.5)
Balance at the end of period	$131.6
Net unrealized gain included in earnings related to instruments still held at the end of period	75.6

Unrealized gains and losses included in earnings related to Integrys Energy Services' risk management assets and liabilities are recorded through nonregulated revenue on the Condensed Consolidated Statements of Income. Realized gains and losses on these same instruments are recorded in nonregulated revenue or nonregulated cost of fuel, natural gas, and purchased power, depending on the nature of the instrument. Unrealized gains and losses on Level 3 derivatives at the utilities are deferred as regulatory assets or liabilities. Therefore, these fair value measurements have no impact on earnings. Realized gains and losses on these instruments flow through utility cost of fuel, natural gas, and purchased power on the Condensed Consolidated Statements of Income.

Fair Value of Financial Instruments

The following table shows the financial instruments included on the Condensed Consolidated Balance Sheets of Integrys Energy Group that are not recorded at fair value.

	March 31, 2010		**December 31, 2009**	
(Millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Long-term debt	**$2,459.6**	**$2,530.1**	$2,511.2	$2,543.6
Preferred stock	**51.1**	**46.5**	51.1	44.3

The fair values of long-term debt instruments are estimated based on the quoted market price for the same or similar issues, or on the current rates offered to Integrys Energy Group for debt of the same remaining maturity, without considering the effect of third-party credit enhancements. The fair values of preferred stock are estimated based on quoted market prices when available, or by using a perpetual dividend discount model.

Due to the short-term nature of cash and cash equivalents, accounts receivable, accounts payable, notes payable, and outstanding commercial paper, the carrying amount approximates fair value.

NOTE 21—MISCELLANEOUS INCOME

Integrys Energy Group's total miscellaneous income was as follows:

	Three Months Ended March 31	
(Millions)	**2010**	**2009**
Equity earnings on investments	**$19.7**	$18.4
Gain on sale of property	**-**	1.8
Other	**0.7**	0.9
Total miscellaneous income	**$20.4**	$21.1

NOTE 22--REGULATORY ENVIRONMENT

Wisconsin

2011 Rate Case

On April 1, 2010, WPS filed an application with the PSCW to increase retail electric and natural gas rates $64.2 million (6.9%) and $5.0 million (1.2%), respectively, with rates effective January 1, 2011. The filing includes a request for an 11.25% return on common equity and a common equity ratio of 53.62% in WPS's regulatory capital structure. The proposed retail electric and natural gas rate increases for 2011 are being driven by decreased sales due primarily to the ongoing economic recession and increased energy efficiency efforts by customers, the amortization in 2011 of deferred amounts under WPS's electric Revenue Stabilization Mechanism, and increased payments to the Wisconsin Focus on Energy program.

2010 Rates

On December 22, 2009, the PSCW issued a final written order for WPS authorizing an electric rate increase of $18.2 million, offset by an $18.2 million refund of 2009 and 2008 fuel costs, and a retail natural gas rate increase of $13.5 million, effective January 1, 2010. Based on an order issued on April 1, 2010, the remaining $10.0 million of the 2008 and 2009 fuel cost over-collections, plus interest of $1.3 million, will be refunded to customers based on April 2010 sales. As of March 31, 2010, the remaining balance of the 2008 and 2009 fuel cost over-collections to be refunded to customers in 2010 was $24.4 million, which has been recorded as a short-term regulatory liability. Fuel cost over/under-recovery impacts related to the Weston 4 power plant exfoliation issue remain open for 2008 and 2009 and have been delayed to a future rate proceeding.

2009 Rates

On December 30, 2008, the PSCW issued a final written order for WPS authorizing no change in retail electric rates from the fuel surcharge adjusted rates authorized effective July 4, 2008, and a $3.0 million decrease in retail natural gas rates. The PSCW also approved a decoupling mechanism as a four-year pilot program. The mechanism allows WPS to defer and recover or refund in future rate proceedings all or a portion of the differences between the actual and authorized margin per customer impact of variations in volumes. The annual deferral or refund is limited to $14.0 million for electric service and $8.0 million for natural gas service. The mechanism does not adjust for changes in volume resulting from changes in customer count and also does not cover large commercial and industrial customers.

Michigan

2010 UPPCO Rates

On December 16, 2009, the MPSC issued a final written order authorizing UPPCO a retail electric rate increase of $6.5 million, effective January 1, 2010. The new rates reflect a 10.90% return on common equity and a common equity ratio of 54.83% in UPPCO's regulatory capital structure. The order includes approval of a decoupling mechanism, as well as an uncollectibles expense tracking mechanism, which allows for the deferral and subsequent recovery or refund of 80% of the difference between actual write-offs (net of recoveries) and bad debt expense included in utility rates, both effective January 1, 2010.

2010 MGU Rates

On December 16, 2009, the MPSC issued a final written order authorizing MGU a retail natural gas rate increase of $3.5 million, effective January 1, 2010. The filing includes a 10.75% return on common equity and a common equity ratio of 50.26% in MGU's regulatory capital structure. The order includes approval of an uncollectibles expense tracking mechanism, which allows for the deferral and subsequent recovery or refund of 80% of the difference between actual write-offs (net of recoveries) and bad debt expense included in utility rates, effective January 1, 2010. The decoupling mechanism proposed in the rate case is being contested and was not part of the order. An MPSC decision on decoupling is expected in the second quarter of 2010.

2009 MGU Rates

On January 13, 2009, the MPSC issued a final written order for MGU approving a settlement agreement authorizing an annual retail natural gas rate increase of $6.0 million, effective January 14, 2009. The new rates reflected a 10.45% return on common equity and a common equity ratio of 50.01% in MGU's regulatory capital structure.

Illinois

2010 Rates

On January 21, 2010, the ICC issued a final written order authorizing a retail natural gas rate increase of $69.8 million for PGL and $13.9 million for NSG, effective January 28, 2010. The rates for PGL reflect a 10.23% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The rates for NSG reflect a 10.33% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The ICC approved a rider mechanism to recover the costs, above an annual baseline, of an accelerated natural gas main replacement program by PGL through a special charge on customers' bills, known as Rider ICR. In February 2010, prior to the ICC granting rehearing on this issue, PGL filed Rider ICR with a $51.85 million annual baseline. On rehearing, PGL proposed a baseline of $45.28 million with an annual escalation factor. No party filed testimony opposing the proposal. Recovery of costs for the accelerated gas main replacement program will begin in 2011 with the first Rider ICR charges being effective April 1, 2011. The rate order also approved the recovery of net dismantling costs of property, plant, and equipment over the life of the asset rather than when incurred. PGL and NSG, as well as Chicago, the AG, and the Citizens Utility Board, filed requests for rehearing in February 2010, all addressing Rider ICR. On March 10, 2010, the ICC voted to grant rehearing on the Rider ICR annual baseline determination and denied all other rehearing requests, including requests about other aspects of Rider ICR with a rehearing order expected in the summer of 2010. The AG, the Citizens Utility Board, PGL, and NSG filed appeals with the Illinois appellate court of the ICC's order denying rehearing on certain other issues.

Recent Illinois Legislation

In July 2009, Illinois Senate Bill (SB) 1918 was signed into law. SB 1918 contains a provision that allows PGL and NSG to file a rider to recover (or refund) the incremental difference between the rate case authorized uncollectible expense and the actual uncollectible expense reported to the ICC each year. PGL and NSG filed their respective riders with the ICC in September 2009, and began recording the effects of this provision at that time. The ICC approved the rider in February 2010. SB 1918 also requires a percentage of income payment plan for low-income utility customers that PGL and NSG are offering as a transition program in 2010 and 2011, with a permanent program to begin no later than September 1, 2011, as well as an on-bill financing program that PGL and NSG filed in February 2010 with a requested June 2011 effective date. The on-bill financing program will allow certain residential customers of PGL and NSG to borrow funds from a third party lender to purchase energy efficiency measures and pay back the borrowed funds over time through a charge on their utility bill. No later than October 1, 2010, PGL and NSG must file an EEP to meet specified energy efficiency standards, with the first program year beginning June 2011. The legislation did not have a significant impact on PGL or NSG during the quarter ended March 31, 2010.

2008 Rates

On February 5, 2008, the ICC issued a final written order authorizing a retail natural gas rate increase of $71.2 million for PGL and a retail natural gas rate decrease of $0.2 million for NSG, effective February 14, 2008. The rates for PGL reflected a 10.19% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The rates for NSG reflected a 9.99% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The order included approval of a decoupling mechanism, effective March 1, 2008, as a four-year pilot program, which allows PGL and NSG to adjust rates going forward to recover or refund the difference between the actual and authorized margin impact of variations in volumes. Legislation was introduced, but not enacted, at the Illinois state legislature to roll back decoupling. Integrys Energy Group actively supports the ICC's decision to approve this rate setting mechanism. The order also approved an EEP, which allows PGL and NSG to recover up to $6.4 million and $1.1 million per year, respectively, of energy efficiency costs. This EEP is separate from, and will be replaced by, the SB 1918 required EEP.

On March 26, 2008, the ICC denied PGL's and NSG's request for rehearing of their rate orders, and all but one such request from interveners, which only affected PGL. The ICC approved a stipulation resolving the rehearing issue. Following the stipulation approval, PGL and NSG and four other parties filed appeals with the Illinois appellate court. Issues on appeal include the decoupling mechanism.

Minnesota

2010 Rates

On December 4, 2009, the MPUC approved a final written order authorizing MERC a retail natural gas rate increase of $15.4 million, effective January 1, 2010. The new rates reflect a 10.21% return on common equity and a common equity ratio of 48.77% in its regulatory capital structure. Since the final approved rate increase was lower than the interim rate increase that went into effect in October 2008, refunds were made to customers in March 2010.

Federal

Through a series of orders issued by the FERC, Regional Through and Out Rates for transmission service between the MISO and the PJM Interconnection were eliminated effective December 1, 2004. To compensate transmission owners for the revenue they will no longer receive due to this rate elimination, the FERC ordered a transitional pricing mechanism called the Seams Elimination Charge Adjustment (SECA) be put into place. Load-serving entities paid these SECA charges during a 16-month transition period from December 1, 2004, through March 31, 2006.

For the 16-month transitional period, Integrys Energy Services received billings of $19.2 million (pre-tax) for these charges. Integrys Energy Services expensed $14.7 million of the $19.2 million, as it is probable that Integrys Energy Services' total exposure will be reduced by at least $4.5 million due to inconsistencies between the FERC's SECA order and the transmission owners' compliance filings. Integrys Energy Services has reached settlement agreements with three of its vendors for a combined $1.6 million.

In August 2006, the administrative law judge hearing the case issued an Initial Decision that was in agreement with all of Integrys Energy Services' positions. If the Final Order is consistent with the Initial Decision of the administrative law judge, Integrys Energy Services' pre-tax exposure of $19.2 million may be reduced by as much as $13 million. The Final FERC Order is subject to rehearing and then court challenges. Any refunds to Integrys Energy Services will include interest for the period from payment to refund. A FERC Order addressing these issues is expected to be received by June 2010.

NOTE 23—SEGMENTS OF BUSINESS

At March 31, 2010, Integrys Energy Group reported five segments, which are described below.

- The electric utility segment includes the regulated electric utility operations of WPS and UPPCO.
- The natural gas utility segment includes the regulated natural gas utility operations of WPS, MGU, MERC, PGL, and NSG.
- Integrys Energy Services is a diversified nonregulated natural gas and electric power supply and services company serving retail customers (residential, commercial, and industrial).
- The electric transmission investment segment includes Integrys Energy Group's approximate 34% ownership interest in ATC. ATC is a federally regulated electric transmission company operating in Wisconsin, Michigan, Minnesota, and Illinois.
- 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 also included in the holding company and other segment.

The tables below present information for the respective periods pertaining to Integrys Energy Group's reportable segments:

	Regulated Operations				Nonutility and Nonregulated Operations			
(Millions)	Electric Utility	Natural Gas Utility	Electric Transmission Investment	Total Regulated Operations	Integrys Energy Services	Holding Company and Other	Reconciling Eliminations	Integrys Energy Group Consolidated
Three Months Ended March 31, 2010								
External revenues	$330.1	$926.5	$ -	$1,256.6	$643.8	$ 3.0	$ -	$1,903.4
Intersegment revenues	4.8	0.2	-	5.0	0.8	-	(5.8)	-
Restructuring expense	-	-	-	-	2.5	0.2	-	2.7
Net loss on Integrys Energy Services' dispositions related to strategy change	-	-	-	-	39.8	-	-	39.8
Depreciation and amortization expense	24.4	30.7	-	55.1	4.7	4.4	-	64.2
Miscellaneous income (expense)	0.2	0.5	19.5	20.2	0.5	10.5	(10.8)	20.4
Interest expense (income)	10.8	13.1	-	23.9	3.4	22.9	(10.8)	39.4
Provision (benefit) for income taxes	18.1	56.6	7.9	82.6	(28.9)	(3.6)	-	50.1
Net income (loss) from continuing operations	26.7	69.9	11.6	108.2	(48.6)	(9.4)	-	50.2
Discontinued operations	-	-	-	-	0.1	-	-	0.1
Preferred stock dividends of subsidiary	(0.6)	(0.2)	-	(0.8)	-	-	-	(0.8)
Net income (loss) attributed to common shareholders	26.1	69.7	11.6	107.4	(48.5)	(9.4)	-	49.5

(Millions)	Regulated Operations: Electric Utility	Regulated Operations: Natural Gas Utility	Regulated Operations: Electric Transmission Investment	Total Regulated Operations	Nonutility and Nonregulated Operations: Integrys Energy Services	Nonutility and Nonregulated Operations: Holding Company and Other	Reconciling Eliminations	Integrys Energy Group Consolidated
Three Months Ended March 31, 2009								
External revenues	$317.9	$1,096.6	$ -	$1,414.5	$1,783.5	$ 2.8	$ -	$3,200.8
Intersegment revenues	11.8	0.2	-	12.0	0.6	-	(12.6)	-
Goodwill impairment loss	-	291.1	-	291.1	-	-	-	291.1
Depreciation and amortization expense	22.4	25.8	-	48.2	5.1	3.6	-	56.9
Miscellaneous income (expense)	0.9	1.2	18.0	20.1	0.9	13.7	(13.6)	21.1
Interest expense (income)	10.5	13.6	-	24.1	3.1	29.1	(13.6)	42.7
Provision (benefit) for income taxes	14.3	4.0	7.2	25.5	(14.5)	1.8	-	12.8
Net income (loss)	27.7	(172.9)	10.8	(134.4)	(29.2)	(15.9)	-	(179.5)
Preferred stock dividends of subsidiary	(0.6)	(0.2)	-	(0.8)	-	-	-	(0.8)
Net income (loss) attributed to common shareholders	27.1	(173.1)	10.8	(135.2)	(29.1)	(15.9)	-	(180.2)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the accompanying condensed consolidated financial statements and related notes and Integrys Energy Group's Annual Report on Form 10-K for the year ended December 31, 2009.

SUMMARY

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).

RESULTS OF OPERATIONS

First Quarter 2010 Compared with First Quarter 2009

(Millions, except per share amounts)	Three Months Ended March 31 2010	2009	Change in 2010 Over 2009
Natural gas utility operations	**$ 69.7**	$(173.1)	N/A
Electric utility operations	**26.1**	27.1	(3.7)%
Integrys Energy Services' operations	**(48.5)**	(29.1)	66.7 %
Electric transmission investment	**11.6**	10.8	7.4 %
Holding company and other operations	**(9.4)**	(15.9)	(40.9)%
Net income (loss) attributed to common shareholders	**$ 49.5**	$(180.2)	N/A
Basic earnings (loss) per share	**$0.64**	$(2.35)	N/A
Diluted earnings (loss) per share	**$0.64**	$(2.35)	N/A
Average shares of common stock			
Basic	**76.9**	76.7	0.3 %
Diluted	**77.2**	76.7	0.7 %

Summary of Financial Results

Integrys Energy Group recognized net income attributed to common shareholders of $49.5 million ($0.64 diluted earnings per share) for the quarter ended March 31, 2010, compared with a net loss attributed to common shareholders of $180.2 million ($2.35 net loss per share) for the quarter ended March 31, 2009. Significant factors impacting the $229.7 million increase in earnings were as follows (and are discussed in more detail thereafter):

- Earnings at the regulated natural gas utility segment increased $242.8 million, driven by the positive quarter-over-quarter impact of a $248.8 million after-tax non-cash goodwill impairment loss recorded in the first quarter of 2009. Earnings also benefited $15.0 million from rate increases implemented at certain natural gas utilities in the first quarter of 2010 and $4.0 million from an after-tax decrease in bad debt expense. These positive impacts were partially offset by a $6.6 million after-tax decrease in margin related to lower quarter-over-quarter volumes, net of decoupling, a non-recurring $6.5 million increase in provision for income taxes related to new health care legislation, which eliminated the deductibility of payments for retiree prescription drugs subject to a federal subsidy, and higher operating expenses. Higher operating expenses included a $4.4 million after-tax increase in employee benefit costs, a $2.9 million after-tax increase in depreciation and amortization expense related to recovery under a new rate order, and a $1.9 million after-tax increase related to energy efficiency initiatives.

- Earnings at the regulated electric utility segment decreased $1.0 million, driven by a $5.0 million after-tax increase in operating expenses, primarily related to increases in employee benefit costs, electric transmission expense, and customer assistance expense. Federal health care legislation enacted in March 2010 also had a non-recurring $4.5 million negative impact on electric earnings as a result of an increase in provision for income taxes, since payments for retiree prescription drugs subject to a federal subsidy will no longer be deductible under the new legislation. The decrease in regulated electric utility segment earnings was partially offset by a $7.3 million after-tax increase in margin, primarily related to lower fuel and purchased power costs incurred in the first quarter of 2010, compared with fuel and purchased power cost recovery rates set in 2009 (which WPS was allowed to retain as part of its limited rate case re-opener for 2010), as well as retail rate increases at WPS and UPPCO.

- The net loss at Integrys Energy Services increased $19.4 million, driven by after-tax losses on dispositions of $23.9 million, primarily related to the divestiture of the United States wholesale electric marketing and trading business. These losses primarily resulted from the same mark-to-market timing differences that have historically caused earnings volatility within Integrys Energy Services. Also contributing to the increase in Integrys Energy Services' net loss was a $5.9 million after-tax decrease in Integrys Energy Services' margin quarter-over-quarter, primarily related to lower realized natural gas and electric margins driven by Integrys Energy Services' strategy change, as well as the negative quarter-over-quarter impact of withdrawals of natural gas from storage for which inventory valuation adjustments were previously recorded, partially offset by the positive quarter-over-quarter impact of lower non-cash accounting losses due to derivative fair value adjustments. The increase in Integrys Energy Services' net loss was partially offset by an after-tax decrease in operating and maintenance expenses of $11.3 million.

- Earnings at the electric transmission investment segment increased $0.8 million, due to an increase in income from Integrys Energy Group's ownership interest in ATC.

- The net loss at the holding company and other segment decreased $6.5 million, largely due to a quarter-over-quarter decrease in the effective tax rate for this segment. The effective tax rate of this segment includes the effect of certain state income taxes at the consolidated level that are not allocated to other segments. One specific item affecting income tax expense for this segment during the first quarter of 2009 was the negative impact of a February 2009 tax law change in Wisconsin. Also contributing to the decrease in net loss at this segment was lower short-term external interest expense.

Utility Operations

For the quarters ended March 31, 2010, and 2009, utility operations included the regulated natural gas utility segment, consisting of the regulated 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.

Regulated Natural Gas Utility Segment Operations

(Millions, except heating degree days)	Three Months Ended March 31 2010	Three Months Ended March 31 2009	Change in 2010 Over 2009
Revenues	$926.7	$1,096.8	(15.5)%
Purchased natural gas costs	607.4	776.3	(21.8)%
Margins	319.3	320.5	(0.4)%
Operating and maintenance expense	140.5	151.1	(7.0)%
Goodwill impairment loss *	-	291.1	(100.0)%
Depreciation and amortization expense	30.7	25.8	19.0 %
Taxes other than income taxes	9.0	9.0	-
Operating income (loss)	139.1	(156.5)	N/A
Miscellaneous income	0.5	1.2	(58.3)%
Interest expense	(13.1)	(13.6)	(3.7)%
Other expense	(12.6)	(12.4)	1.6 %
Income (loss) before taxes	$126.5	$(168.9)	N/A
Throughput in therms			
Residential	736.5	795.9	(7.5)%
Commercial and industrial	224.5	253.3	(11.4)%
Interruptible	16.1	18.0	(10.6)%
Interdepartmental	3.3	2.1	57.1 %
Transport	601.4	613.4	(2.0)%
Total sales in therms	1,581.8	1,682.7	(6.0)%
Weather			
Average heating degree days	3,282	3,587	(8.5)%

* See Note 8, "*Goodwill and Other Intangible Assets*," for more information.

First Quarter 2010 Compared with First Quarter 2009

Regulated natural gas utility segment revenue decreased $170.1 million quarter-over-quarter, driven by:

- An approximate $115 million decrease in revenue as a result of an approximate 14% decrease in the average per-unit cost of natural gas sold by the regulated natural gas utilities during the quarter ended March 31, 2010, compared with the same quarter in 2009. 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 $65 million decrease in revenue as a result of lower natural gas throughput volumes, driven by:

  - An approximate $54 million decrease as a result of warmer quarter-over-quarter weather during the first quarter heating season, evidenced by the 8.5% decrease in average heating degree days.

  - An approximate $17 million decrease related to lower volumes, including residential customer volumes, resulting from customer conservation and efficiency efforts. Lower volumes were also experienced by commercial and industrial customers, resulting from reduced demand related to changes in customers' plant operations and a decline in customer base at PGL, NSG, and MGU, both of which Integrys Energy Group attributed to the general economic slowdown.

  - A partially offsetting approximate $6 million net positive quarter-over-quarter impact of decoupling mechanisms for residential, small commercial and industrial, and transportation customers at PGL, NSG, and WPS. 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 $15 million decrease in revenue from lower recovery of environmental cleanup expenditures related to former manufactured gas plant sites.

- The decrease in revenue was partially offset by the approximate $25 million positive impact of natural gas distribution rate orders at the regulated natural gas utilities. See Note 22, "*Regulatory Environment*," for more information on these rate orders.

  - PGL and NSG received final rate orders from the ICC for retail natural gas distribution rate increases that were effective January 28, 2010, which had an approximate $18 million positive impact on revenue.

  - WPS received a final rate order from the PSCW for a retail natural gas distribution rate increase that was effective January 1, 2010, which had an approximate $6 million positive impact on revenue.

  - MGU received a final rate order from the MPSC for a retail natural gas distribution rate increase that was effective January 1, 2010, which had an approximate $1 million positive impact on revenue.

Margins

Regulated natural gas utility segment margin decreased $1.2 million quarter-over-quarter, driven by:

- An approximate $15 million decrease in margin due to lower recovery of environmental cleanup expenditures related to former manufactured gas plant sites. This decrease in margin was offset by a decrease in operating expense from the amortization of the related regulatory asset and, therefore, had no impact on earnings.

- An approximate $11 million decrease in margin resulting from the 6.0% decrease in natural gas throughput volumes attributed to warmer quarter-over-quarter weather, customer conservation and efficiency efforts, and the negative impact from the general economic slowdown. This decrease in margin includes an approximate $6 million net positive impact from decoupling mechanisms in place at PGL, NSG, and WPS. 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. This cap was reached prior to the end of the first quarter of 2010, negatively impacting WPS's natural gas margin quarter-over-quarter by $1.1 million. Additionally, no decoupling deferral can be recorded at WPS if there are any additional shortfalls from authorized margin for the remainder of 2010.

- The decrease in margin was partially offset by the approximate $25 million positive impact of rate orders at the regulated natural gas utilities.

Operating Income (Loss)

Operating income at the regulated natural gas utility segment increased $295.6 million, from an operating loss of $156.5 million in the first quarter of 2009, to operating income of $139.1 million in the first quarter of 2010. This increase was primarily driven by the positive impact of a $291.1 million non-cash goodwill impairment loss that was recorded in the first quarter of 2009, and a quarter-over-quarter $5.7 million decrease in other operating expenses, partially offset by the $1.2 million decrease in natural gas margin. See Note 8, "*Goodwill and Other Intangible Assets*," for information related to the goodwill impairment loss recorded in 2009.

The $5.7 million quarter-over-quarter decrease in other operating expenses primarily related to:

- An approximate $15 million decrease in amortization of the regulatory asset related to environmental cleanup expenditures of manufactured gas plant sites. These costs were recovered from customers in rates.
- A $6.7 million decrease in bad debt expense, primarily related to the impact lower volumes and lower energy prices had on overall accounts receivable balances.
- These decreases were partially offset by:
  - A $7.3 million increase in employee benefit costs, partially related to an increase in pension and post-retirement medical expenses, resulting from the amortization of negative investment returns from 2008 and a decrease in the discount rate utilized in the most recent valuation.
  - A $4.9 million increase in depreciation and amortization expense, primarily related to the ICC's rate order for PGL and NSG, effective January 28, 2010, which allows recovery of net dismantling costs by including it as a component of depreciation rates applied to natural gas distribution assets.
  - A $3.2 million increase in operating expenses related to energy conservation programs and enhanced efficiency initiatives.

Regulated Electric Utility Segment Operations

(Millions, except heating degree days)	Three Months Ended March 31 2010	2009	Change in 2010 Over 2009
Revenues	$334.9	$329.7	1.6 %
Fuel and purchased power costs	140.4	147.4	(4.7)%
Margins	194.5	182.3	6.7 %
Operating and maintenance expense	102.5	96.3	6.4 %
Depreciation and amortization expense	24.4	22.4	8.9 %
Taxes other than income taxes	12.2	12.0	1.7 %
Operating income	55.4	51.6	7.4 %
Miscellaneous income	0.2	0.9	(77.8)%
Interest expense	(10.8)	(10.5)	2.9 %
Other expense	(10.6)	(9.6)	10.4 %
Income before taxes	$ 44.8	$ 42.0	6.7 %
Sales in kilowatt-hours			
Residential	792.8	843.1	(6.0)%
Commercial and industrial	2,027.0	1,998.9	1.4 %
Wholesale	1,211.7	1,135.4	6.7 %
Other	11.2	11.5	(2.6)%
Total sales in kilowatt-hours	4,042.7	3,988.9	1.3 %
Weather			
WPS:			
Heating degree days	3,444	3,971	(13.3)%
UPPCO:			
Heating degree days	3,592	4,249	(15.5)%

First Quarter 2010 Compared with First Quarter 2009

Revenues

Regulated electric utility segment revenues increased $5.2 million quarter-over-quarter, driven by:

- An approximate $8 million increase in opportunity sales at WPS, made possible by a combination of an increase in available capacity (which resulted from lower residential, small commercial and industrial, and contracted wholesale sales), and low-cost generation at Weston 4.

- An approximate $5 million increase due to a 6.1% increase in sales volumes to large commercial and industrial customers related to changes in plant operations, which Integrys Energy Group attributes mainly to improving general economic conditions.

- An approximate $3 million increase in revenues related to retail electric rate increases at both WPS and UPPCO, effective January 1, 2010.

- These increases in regulated electric utility segment revenues were partially offset by:

  - An approximate $8 million decrease in revenues from wholesale customers due to a decrease in contracted sales volumes and fuel costs. The decrease in fuel costs caused a decrease in per-unit revenues because commodity costs are passed directly through to these customers in rates.

  - An approximate $3 million decrease in revenues, net of decoupling, due to a 4.5% decrease in sales volumes to residential and small commercial and industrial customers primarily related to warmer quarter-over-quarter weather during the heating season as evidenced by the decrease in heating degree days at both WPS and UPPCO. In the first quarter of 2010, WPS recorded an $11.3 million benefit from electric decoupling (which is subject to an annual $14.0 million cap), compared with $5.6 million in the first quarter of 2009. UPPCO did not have a decoupling mechanism in 2009, but recorded a $1.1 million benefit from decoupling in the first quarter of 2010.

Margins

Regulated electric utility segment margins increased $12.2 million quarter-over-quarter, driven by:

- An approximate $8 million increase related to lower fuel and purchased power costs incurred in the first quarter of 2010 compared with fuel and purchased power cost recovery rates set in 2009, which WPS was allowed to retain as part of its limited rate case re-opener for 2010.

- An approximate $3 million increase related to retail electric rate increases at both WPS and UPPCO, effective January 1, 2010.

Operating Income

Operating income at the regulated electric utility segment increased $3.8 million quarter-over-quarter, driven by the $12.2 million increase in electric margin, partially offset by an $8.4 million increase in operating expenses.

The increase in operating expenses was the result of:

- A $4.0 million increase in employee benefit costs, primarily related to an increase in pension and other postretirement benefit expenses, driven by the amortization of negative investment returns from 2008, and a decrease in the discount rate utilized in the most recent valuation.

- A $3.6 million increase in electric transmission expense.

- A $3.0 million increase in customer assistance expense related to payments made to the Focus on Energy program, which aims to help residents and businesses install cost-effective, energy efficient, and renewable energy products.
- A $1.9 million increase in depreciation and amortization expense at WPS, primarily related to the Crane Creek Wind Farm being placed in service for accounting purposes in December 2009.
- These increases were partially offset by a $3.0 million decrease in electric maintenance expense at WPS, primarily related to a greater number of planned outages at the generation plants during the first quarter of 2009, compared with the first quarter of 2010.

Other Expense

Other expense at the regulated electric utilities increased $1.0 million, driven by a $1.0 million decrease in AFUDC related to the Crane Creek Wind Farm.

Integrys Energy Services' Operations

Integrys Energy Services is a diversified nonregulated energy supply and services company serving residential, commercial, and industrial customers.

Integrys Energy Services Segment Results of Operations

(Millions, except natural gas sales volumes)	Three Months Ended March 31 2010	2009	Change in 2010 Over 2009
Revenues	$644.6	$1,784.1	(63.9)%
Cost of fuel, natural gas, and purchased power	638.2	1,767.8	(63.9)%
Margins	6.4	16.3	(60.7)%
Margin Detail			
Electric and other margins	(16.7) [1]	(23.1) [1]	(27.7)%
Natural gas margins	23.1 [2]	39.4 [2]	(41.4)%
Operating and maintenance expense	30.8	49.6	(37.9)%
Restructuring expense	2.5	-	N/A
Net loss on Integrys Energy Services' dispositions related to strategy change	39.8	-	N/A
Depreciation and amortization	4.7	5.1	(7.8)%
Taxes other than income taxes	3.2	3.1	3.2 %
Operating loss	(74.6)	(41.5)	79.8 %
Miscellaneous income	0.5	0.9	(44.4)%
Interest expense	(3.4)	(3.1)	9.7 %
Other expense	(2.9)	(2.2)	31.8 %
Net loss before taxes	$ (77.5)	$ (43.7)	77.3 %
Physical volumes (includes only transactions settled physically for the periods shown)			
Wholesale electric sales volumes in kwh	477.1	1,035.9	(53.9)%
Retail electric sales volumes in kwh	3,153.3	3,997.3	(21.1)%
Wholesale natural gas sales volumes in bcf	21.9	160.9	(86.4)%
Retail natural gas sales volumes in bcf	50.4	97.3	(48.2)%

kwh – kilowatt-hours
bcf – billion cubic feet

(1) For the three months ended March 31, 2010, and 2009, these amounts included negative margin of $43.1 million and $59.1 million, respectively, related to fair value adjustments.

(2) For the three months ended March 31, 2010, and 2009, these amounts included negative margin of $9.1 million and $45.8 million, respectively, related to fair value adjustments, and positive margin of $4.6 million and $19.0 million, respectively, related to lower-of-cost-or-market inventory adjustments.

First Quarter 2010 Compared with First Quarter 2009

Revenues

Revenues decreased $1,139.5 million quarter-over-quarter, as a result of Integrys Energy Group's decision to reposition Integrys Energy Services to focus on selected retail markets and investments in energy assets with renewable attributes. See Note 5, "*Dispositions*," for a discussion of the dispositions completed in connection with Integrys Energy Services' strategy change.

Margins

Changes in commodity prices subject a portion of the nonregulated operations to earnings volatility. 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 include 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 decreased $9.9 million quarter-over-quarter. The significant items contributing to the change in margins were as follows:

Electric and Other Margins

Integrys Energy Services' electric and other margins increased $6.4 million quarter-over-quarter. 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 decreased $3.2 million, from $4.1 million during the first quarter of 2009, to $0.9 million during the same quarter in 2010.

Wholesale transactions and structured origination activity were significantly scaled back in conjunction with Integrys Energy Services' sale of substantially all of its United States wholesale electric marketing and trading business. See Note 5, "*Dispositions*," for more information on Integrys Energy Services' sale of its United States wholesale electric marketing and trading business.

Realized margin from energy assets

Realized margin from energy assets decreased $0.2 million. The margin from generating assets, other than assets with renewable attributes, decreased by $2.8 million, from $7.3 million during the first quarter of 2009, to $4.5 million during the same quarter in 2010. Contributing to the decrease was the January 2010 sale of the generation businesses in New Brunswick, Canada and Northern Maine. See Note 5, "*Dispositions*," for more information on the sale. Partially offsetting the decrease was an increase in margin from energy assets with renewable attributes of $2.6 million, from $1.0 million during the first quarter of 2009, to $3.6 million during the same quarter in 2010, driven by Integrys Energy Services' continuing investments in energy assets with renewable attributes, such as solar energy projects and landfill gas projects.

Realized retail electric margin

The realized retail electric margin decreased $6.2 million, from $23.6 million during the first quarter of 2009, to $17.4 million during the same quarter in 2010. The decrease was driven by:

- A $3.7 million decrease in the Illinois market, caused by a 27% decrease in sales volumes, resulting from Integrys Energy Services' reduced marketing efforts before the decision was made to continue business activity in this market.

- A $2.3 million decrease in the Texas market. The decrease was due to Integrys Energy Services' scaled back new business activity in this market in the second half of 2009, as this market is not part of Integrys Energy Services' long-term strategy.

Retail and wholesale electric fair value adjustments

Integrys Energy Services' margin from retail and wholesale electric fair value adjustments increased $16.0 million, as it recognized $59.1 million of non-cash unrealized losses related to derivative instruments during the first quarter of 2009, compared with $43.1 million of non-cash unrealized losses during the same quarter in 2010.

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.

Natural Gas Margins

Integrys Energy Services' natural gas margins decreased $16.3 million quarter-over-quarter. 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 was a $14.4 million quarter-over-quarter net decrease in the natural gas margin. The average market price of natural gas decreased approximately 22% during the first quarter of 2010 and decreased approximately 24% during the same quarter in 2009, driving lower-of-cost-or-market inventory write-downs during both periods in order to reflect natural gas in storage at the end of the period at its net realizable value, as required by GAAP. Integrys Energy Group's strategy change for Integrys Energy Services led to lower inventory volumes in the first quarter of 2010 compared with the same period in 2009; as a result, these write-downs had a positive $34.3 million quarter-over-quarter impact on natural gas margins. In addition, a lower volume of natural gas inventory withdrawn from storage for which write-downs had previously been recorded resulted in a $48.7 million quarter-over-quarter decrease in the natural gas margin.

Realized retail natural gas margins

Realized retail natural gas margins decreased $10.3 million, from $39.5 million during the first quarter of 2009, to $29.2 million during the same quarter in 2010. The decrease in realized retail natural gas margins was driven by an $8.1 million decrease in the Illinois market caused by the quarter-over-quarter negative impact of the withdrawal of a significant amount of natural gas from storage in the first quarter of 2009, resulting in realized gains during that period. Also contributing to the decrease in retail natural gas margins was the sale of Integrys Energy Services' Canadian natural gas portfolio in September 2009, which led to no Canadian margins being realized in 2010.

Realized wholesale natural gas margins

Realized wholesale natural gas margins decreased $28.3 million, from $26.7 million during the first quarter of 2009, to a negative $1.6 million during the same quarter in 2010. Wholesale transactions were significantly scaled back in conjunction with Integrys Energy Services' sale of substantially all of its wholesale natural gas business. See Note 5, "*Dispositions*," for more information on Integrys Energy Services' sale of its wholesale natural gas business.

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 $36.7 million increase in natural gas margins, as unrealized losses on these instruments were $9.1 million during the first quarter of 2010, compared with unrealized losses of $45.8 million during the same quarter in 2009.

Operating Loss

Integrys Energy Services' operating loss increased $33.1 million quarter-over-quarter. This increase resulted from the $9.9 million decrease in margin discussed above, and losses of $39.8 million related to dispositions completed in connection with Integrys Energy Services' strategy change, partially offset by an $18.8 million decrease in operating and maintenance expense.

The decrease in operating and maintenance expense was driven by an $7.9 million decrease in employee payroll and benefit related expenses, a $4.6 million decrease in bad debt expense due to the recovery of a receivable fully reserved during the first quarter of 2009, as well as a general decrease in reserves as a result of reduced business activity, a $2.8 million decrease in broker commissions resulting from reduced business activity, and a $2.0 million decrease in contractor related expenses.

See Note 5, "*Dispositions*," for a discussion of the dispositions completed in connection with Integrys Energy Services' strategy change.

Electric Transmission Investment Segment Operations

First Quarter 2010 Compared with First Quarter 2009

Miscellaneous Income

Miscellaneous income at the electric transmission investment segment increased $1.5 million during the first quarter of 2010 compared with the same quarter in 2009, 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.

Holding Company and Other Segment Operations

(Millions)	Three Months Ended March 31 2010	Three Months Ended March 31 2009	Change in 2010 Over 2009
Operating income (loss)	$ (0.6)	$ 1.3	N/A
Other expense	(12.4)	(15.4)	(19.5)%
Loss before taxes	$(13.0)	$(14.1)	(7.8)%

First Quarter 2010 Compared with First Quarter 2009

Other Expense

Other expense at the holding company and other segment decreased $3.0 million during the first quarter of 2010 compared with the same quarter in 2009, driven by a $2.4 million decrease in external short-term interest expense at the holding company mainly due to lower interest expense on commercial paper. Also contributing to the decrease in other expense at the holding company and other segment was a $1.9 million decrease in external short-term interest expense at PEC, due to the positive quarter-over-quarter impact of borrowings under a revolving credit agreement repaid in May 2009.

Provision for Income Taxes

	Three Months Ended March 31 2010	Three Months Ended March 31 2009
Effective Tax Rate	50.0%	(7.7)%

First Quarter 2010 Compared with First Quarter 2009

The change in the effective tax rate for the quarter ended March 31, 2010, compared to the same quarter in 2009, was primarily related to the tax treatment of Integrys Energy Group's $291.1 million non-cash pre-tax goodwill impairment loss recorded in 2009. Although Integrys Energy Group had a $166.7 million loss before income taxes for the quarter ended March 31, 2009, it still recorded a $12.8 million provision for income taxes because $186.2 million of the total pre-tax goodwill impairment loss was not deductible for income tax purposes.

Also contributing to the increase in the quarter-over-quarter effective tax rate was the elimination of the deductibility of prescription drug payments to retirees, to the extent those payments will be offset by the receipt of the Medicare Part D subsidy, as mandated in the recently passed federal health care legislation. See "*Other Future Considerations – Federal Health Care Reform*" for more information. As a result of the legislation, Integrys Energy Group expensed $11.8 million of deferred income tax benefits during the quarter ended March 31, 2010, which were previously recognized as a reduction in provision for income taxes. This additional provision for income taxes will not reoccur in future periods. The 2010 effective tax rate has also been adjusted to reflect an additional provision for income taxes of $1.9 million related to current year expected retiree benefits.

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.

Operating Cash Flows

During the quarter ended March 31, 2010, net cash provided by operating activities was $419.4 million, compared with $852.6 million for the same quarter in 2009. The $433.2 million quarter-over-quarter decrease in net cash provided by operating activities was largely driven by a $393.0 million decrease in cash provided by working capital. Because natural gas prices dropped significantly during the first quarter of 2009, accounts receivable and accrued unbilled revenues also decreased during this period, generating cash. However, the first quarter of 2010 did not see the same change in prices, therefore accounts receivable and accrued unbilled revenues increased from year-end as a result of high volumes experienced during the heating season. Also contributing to the decrease in cash provided by working capital was a $266.6 million quarter-over-quarter decrease in cash generated by inventories, driven by a larger decrease in natural gas prices over the first quarter of 2009, compared with the first quarter of 2010, and the withdrawal of a significant amount of natural gas from storage at Integrys Energy Services during the first quarter of 2009 in order to improve its liquidity position. Partially offsetting these changes was a $294.9 million quarter-over-quarter decrease in cash used to pay accounts payable balances.

Investing Cash Flows

Net cash used for investing activities was $15.8 million during the quarter ended March 31, 2010, compared with $93.5 million for the same quarter in 2009. The $77.7 million quarter-over-quarter decrease in cash used for investing activities was primarily driven by a $52.5 million quarter-over-quarter increase in proceeds received from the sale or disposal of assets (related to the Integrys Energy Services strategy change), as well as a $26.1 million quarter-over-quarter decrease in cash used to fund capital expenditures (discussed below).

Capital Expenditures

Capital expenditures by business segment for the quarter ended March 31 were as follows:

Reportable Segment *(millions)*	**2010**	**2009**	**Change**
Electric utility	**$23.7**	$43.2	$(19.5)
Natural gas utility	**23.0**	28.3	(5.3)
Integrys Energy Services	**7.6**	11.2	(3.6)
Holding company and other	**8.9**	6.6	2.3
Integrys Energy Group consolidated	**$63.2**	$89.3	$(26.1)

The decrease in capital expenditures at the electric utility segment for the quarter ended March 31, 2010, compared with the same quarter in 2009, was mainly due to decreased expenditures related to the Crane Creek Wind Farm project, which was placed in service for accounting purposes in December 2009.

Financing Cash Flows

Net cash used for financing activities was $189.1 million during the quarter ended March 31, 2010, compared with $681.5 million for the same quarter in 2009. The $492.4 million quarter-over-quarter decrease in cash used for financing activities was driven by a $647.7 million quarter-over-quarter decrease in the repayment of short-term borrowings, mainly due to the generation of more cash from operating activities in 2009 compared with 2010, partially offset by an $86.8 million quarter-over-quarter decrease in proceeds from the sale of borrowed gas, as well as $66.9 million of payments made during the first quarter of 2010 to buyers of the wholesale gas and power businesses for out-of-the-money transactions executed at the time of sale. These contracts were replacement supply trades for the retained retail operations and were transacted at the original transfer price between the wholesale and retail businesses.

Significant Financing Activities

Integrys Energy Group had outstanding commercial paper borrowings of $162.7 million and $143.6 million at March 31, 2010, and 2009, respectively. Integrys Energy Group had short-term notes payable outstanding of $10.0 million at March 31, 2010, and 2009. Integrys Energy Group had no borrowings under revolving credit facilities at March 31, 2010, and $345.0 million at March 31, 2009. See Note 9, "*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 10, "*Long-Term Debt*."

Beginning February 11, 2010, Integrys Energy Group issued new shares of common stock to meet the requirements of its Stock Investment Plan and certain stock-based employee benefit and compensation plans. From January 1, 2010 to February 11, 2010, and during 2009, Integrys Energy Group purchased shares of its common stock on the open market to meet the requirements of these plans.

Credit Ratings

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
Integrys Energy Group		
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
WPS		
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
PEC		
Issuer credit rating	BBB+	N/A
Senior unsecured debt	BBB	Baa1
PGL		
Issuer credit rating	BBB+	A3
Senior secured debt	A-	A2
Commercial paper	A-2	P-2
NSG		
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 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.

Future Capital Requirements and Resources

Contractual Obligations

The following table shows the contractual obligations of Integrys Energy Group, including its subsidiaries, as of March 31, 2010.

		Payments Due By Period			
(Millions)	**Total Amounts Committed**	**2010**	**2011 to 2012**	**2013 to 2014**	**2015 and Thereafter**
Long-term debt principal and interest payments (1)	$3,490.7	$ 167.6	$ 941.5	$ 571.6	$1,810.0
Operating lease obligations	67.4	9.8	20.0	13.6	24.0
Commodity purchase obligations (2)	3,247.1	729.5	1,094.7	642.2	780.7
Purchase orders (3)	405.1	398.7	5.1	1.3	-
Pension and other postretirement funding obligations (4)	682.6	102.1	267.8	138.1	174.6
Total contractual cash obligations	$7,892.9	$1,407.7	$2,329.1	$1,366.8	$2,789.3

(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 $655.5 million at March 31, 2010, 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 13, "*Commitments and Contingencies,*" for more information about environmental liabilities. In addition, the table does not reflect any payments for the March 31, 2010, liability related to uncertain tax positions, as the amount and timing of payments are uncertain. See Note 12, "*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	28.0
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	128.9
IBS	
Corporate services infrastructure projects	53.7
Total capital expenditures	$1,335.3

* 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 these incremental costs. See Note 22, "*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 March 31, 2010, 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.

See Note 9, "*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 10, "*Long-Term Debt*," for more information on Integrys Energy Group's long-term debt and related 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. 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

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 for electric service and an annual $8.0 million cap for natural gas service. The cap for natural gas service was reached in the first quarter of 2010, and WPS had $2.7 million remaining under the cap for electric service at the end of the first quarter of 2010. 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 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. However, the majority of the bad debt expense at the utilities is recovered through rates. Additionally, recoveries (or refunds) under the bad debt riders authorized in Illinois and Michigan will mitigate the effect of bad debt expense for PGL, NSG, MGU, and UPPCO as described in Note 22, "*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. Any annual or interim goodwill impairment test could result in the recognition of a goodwill impairment loss. See Note 8, "*Goodwill and Other Intangible Assets*," for more information on goodwill balances for Integrys Energy Group's reporting units at March 31, 2010.

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, and the Kerry-Boxer draft bill, which was introduced in the United States Senate. 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 its customers' facilities. The physical risks posed by climate change for these areas are not expected to be significant at this time. Ongoing evaluations will be conducted as more information on the extent of such physical changes becomes available.

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 natural gas in facilities located in their states. Because the pipeline does not have title to the working natural 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.

Federal Health Care Reform

In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (HCR) were signed into law. HCR contains various provisions that will affect the cost of providing health care coverage to active and retired employees of Integrys Energy Group and their dependents. Although these provisions become effective at various times over the next 10 years, some provisions that affect the cost of providing benefits to retirees will be reflected starting in 2010.

Most notably, there is a provision of HCR that, beginning in 2013, eliminates the tax deduction for employer-paid postretirement prescription drug charges to the extent those charges will be offset by the receipt of a federal Medicare Part D subsidy. As a result, Integrys Energy Group was required to eliminate a portion of its deferred tax asset related to postretirement benefits. The total amount of the deferred tax asset that was reduced for the loss of the deduction was $11.8 million, all of which flowed through to income as a component of income tax expense in the first quarter of 2010. This additional provision for income taxes will not reoccur in future periods. Integrys Energy Group intends to seek recovery in rates of the income impact of this tax law change related to regulated utility operations in all applicable jurisdictions, but at this time is not able to predict how much will ultimately be recovered in rates.

Other provisions of HCR include the elimination of annual and lifetime maximum benefits, elimination of pre-existing condition restrictions, an excise tax on high-cost health plans, changes to the Medicare Part D prescription drug program, and numerous other changes. Integrys Energy Group is currently evaluating what other impacts the health care legislation may have on its future results of operations, cash flows or financial positions, and if plan structure changes are necessary for its health care programs.

Wisconsin Fuel Rules

Assembly Bill (AB) 600 was introduced to streamline the current fuel rule administered by the PSCW. This bill currently awaits action by the Governor of Wisconsin. The current fuel rule results in regulatory lag and hampers the ability of the PSCW to respond to rapid changes in fuel costs. AB 600 provides for deferral of any change in approved fuel costs in excess of 2% of the fuel costs. Prior to these new rules becoming effective, the PSCW must initiate a rule-making to revise the current fuel rule. As a result, the effective date of the new rules is uncertain.

CRITICAL ACCOUNTING POLICIES

Integrys Energy Group has reviewed its critical accounting policies for new critical accounting estimates and other significant changes and has found that the disclosures made in its Annual Report on Form 10-K for the year ended December 31, 2009, are still current and that there have been no significant changes.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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 its subsidiaries' businesses and the environment in which it operates. 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

To measure commodity price risk exposure, Integrys Energy Group employs a number of controls and processes, including a value-at-risk (VaR) analysis of certain of its exposures. 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. For further explanation of Integrys Energy Group's VaR calculation, see the 2009 Annual Report on Form 10-K.

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

(Millions)	**2010**	2009
As of March 31	**$0.3**	$1.1
Average for 12 months ended March 31	**0.7**	1.4
High for 12 months ended March 31	**1.0**	2.3
Low for 12 months ended March 31	**0.3**	1.1

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

(Millions)	**2010**	2009
As of March 31	**$1.4**	$ 4.7
Average for 12 months ended March 31	**3.0**	6.3
High for 12 months ended March 31	**4.3**	10.2
Low for 12 months ended March 31	**1.4**	4.7

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

The quarter-over-quarter decrease in VaR was driven by a substantial reduction in trading activity, as a result of Integrys Energy Group's decision to reposition Integrys Energy Services to focus on selected retail markets and investments in energy assets with renewable attributes.

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 March 31, 2010, a hypothetical increase in market interest rates of 100 basis points would have increased annual interest expense by $3.0 million. Comparatively, based on the variable rate debt outstanding at March 31, 2009, an increase in interest rates of 100 basis points would have increased interest expense by approximately $6.3 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.

Other than the above-mentioned changes, Integrys Energy Group's market risks have not changed materially from the market risks reported in its 2009 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Integrys Energy Group's management, with the participation of Integrys Energy Group's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of Integrys Energy Group's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report and has concluded that, as of the end of such period, Integrys Energy Group's disclosure controls and procedures were effective to ensure that information required to be disclosed by Integrys Energy Group in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and is accumulated and communicated to Integrys Energy Group's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control

There were no changes in Integrys Energy Group's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2010, that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For information on material legal proceedings and matters related to Integrys Energy Group and its subsidiaries, see Note 13, "*Commitments and Contingencies.*"

Item 1A. Risk Factors

There were no material changes in the risk factors previously disclosed in Part I, Item 1A of Integrys Energy Group's 2009 Annual Report on Form 10-K, which was filed with the SEC on February 26, 2010.

Item 6. Exhibits

The documents listed in the Exhibit Index are attached as exhibits or incorporated by reference herein.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant, Integrys Energy Group, Inc., has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Integrys Energy Group, Inc.

Date: May 5, 2010

/s/ Diane L. Ford
Diane L. Ford
Vice President and Corporate Controller

(Duly Authorized Officer and Chief Accounting Officer)

INTEGRYS ENERGY GROUP
EXHIBIT INDEX TO FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2010

Exhibit No.	Description
3.1	Amendments to the By-Laws of Integrys Energy Group, Inc. effective April 1, 2010 (Incorporated by reference to Exhibit 3.1 to Integrys Energy Group's Form 8-K filed April 1, 2010)
3.2	Integrys Energy Group, Inc. By-Laws as in effect at April 1, 2010 (Incorporated by reference to Exhibit 3.2 to Integrys Energy Group's Form 8-K filed April 1, 2010)
4.1	Forty-First Supplemental Indenture of WPS, dated as of December 18, 2008 (Incorporated by reference to Exhibit 4.1 to WPS's Form 10-Q filed May 5, 2010)
4.2	42nd Supplemental Indenture of WPS, dated as of April 25, 2010 (Incorporated by reference to Exhibit 4.2 to WPS's Form 10-Q filed May 5, 2010)
12	Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act and Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 for Integrys Energy Group
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act and Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 for Integrys Energy Group
32	Written Statement of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 for Integrys Energy Group

ATTACHMENT F

Exhibit 12

INTEGRYS ENERGY GROUP
COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

(Millions)	2010 3 months	2009	2008	2007	2006	2005
EARNINGS						
Net income (loss) from continuing operations	$50.2	($71.6)	$124.7	$181.0	$147.8	$146.1
Provision for income taxes	50.1	83.2	51.2	86.0	45.0	39.6
Income (loss) from continuing operations before income taxes	100.3	11.6	175.9	267.0	192.8	185.7
Less:						
Undistributed earnings of less than 50% owned affiliates	(3.6)	(16.2)	(16.4)	3.8	13.0	7.5
Preferred stock dividends of subsidiary (a)	(1.8)	0.6	(5.1)	(5.2)	(5.3)	(4.9)
Interest capitalized (b)	-	(0.2)	-	-	-	-
Adjusted income (loss) from continuing operations before income taxes	94.9	(4.2)	154.4	265.6	200.5	188.3
Total fixed charges as defined	42.7	172.4	170.8	174.6	107.0	69.5
Total earnings as defined	$137.6	$168.2	$325.2	$440.2	$307.5	$257.8
FIXED CHARGES						
Interest expense	$39.4	$164.8	$158.1	$164.5	$99.2	$62.0
Interest capitalized (c)	0.2	2.6	2.0	0.3	0.2	0.4
Interest factor applicable to rentals	1.3	5.6	5.6	4.6	2.3	2.2
Preferred stock dividends of subsidiary (a)	1.8	(0.6)	5.1	5.2	5.3	4.9
Total fixed charges as defined	$42.7	$172.4	$170.8	$174.6	$107.0	$69.5
RATIO OF EARNINGS TO FIXED CHARGES	3.2	(d)	1.9	2.5	2.9	3.7

(a) Preferred stock dividends of subsidiary are computed by dividing the preferred stock dividends of subsidiary by 100% minus the income tax rate.

(b) Includes interest capitalized for the unregulated segment.

(c) Includes allowance for funds used during construction.

(d) For the 12 months ended December 31, 2009, earnings as defined were inadequate to cover fixed charges as defined by $4.2 million, driven by a pre-tax non-cash goodwill impairment loss of $291.1 million.

ATTACHMENT F

Exhibit 31.1

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act and Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934

I, Charles A. Schrock, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Integrys Energy Group, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2010

/s/ Charles A. Schrock
Charles A. Schrock
Chairman, President and Chief Executive Officer

ATTACHMENT F

Exhibit 31.2

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act and Rule 13a-14(a)
or 15d-14(a) under the Securities Exchange Act of 1934

I, Joseph P. O'Leary, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Integrys Energy Group, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2010

/s/ Joseph P. O'Leary
Joseph P. O'Leary
Senior Vice President and Chief Financial Officer

ATTACHMENT F

Exhibit 32

Written Statement of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to *Section 906 of* the Sarbanes-Oxley Act of 2002, we, the undersigned Chief Executive Officer and Chief Financial Officer of Integrys Energy Group, Inc. (the "Company"), hereby certify, based on our knowledge, that the Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2010 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Charles A. Schrock
Charles A. Schrock
Chairman, President and Chief Executive Officer

/s/ Joseph P. O'Leary
Joseph P. O'Leary
Senior Vice President and Chief Financial Officer

Date: May 5, 2010

ATTACHMENT F

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 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
Common Stock, $1 par value	New York Stock Exchange

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

None

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

Yes [X] No [ ]

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

Yes [ ] No [X]

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

Yes [X] No [ ]

Indicate by check mark 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 [X] Accelerated filer [ ]
Non-accelerated filer [ ] Smaller reporting company [ ]

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

Yes [ ] No [X]

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

$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

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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 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 natûral 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 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 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 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
Local 2285 of the International Brotherhood of Electrical Workers	NSG	June 30, 2013
Local 12295 of the United Steelworkers of America, AFL CIO CLC	MGU	January 15, 2015
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, 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.

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 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.

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.

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 Turbine and Diesel	De Pere Energy Center	De Pere, WI	Natural Gas	166.6	
	Eagle River	Eagle River, WI	Distillate Fuel Oil	4.2	
	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	34.5	(3)
Total Hydroelectric				36.8	
Combustion Turbine and Diesel	Caribou	Caribou ME	Diesel	7.0	(3)
	Flo's Inn	Presque Isle, ME	Diesel	4.2	(3)
	Loring	Limestone, ME	Diesel	5.2	(3)
	Tinker	New Brunswick, Canada	Diesel	1.0	(3)
Total Combustion Turbine and Diesel				17.4	
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

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	01-01-09
		Chairman, President and Chief Executive Officer	05-15-08
		President and Chief Executive Officer	02-21-07
		Chairman, President and Chief Executive Officer	02-12-98
Charles A. Schrock	56	President and Chief Executive Officer	01-01-09
		President and Chief Executive Officer of WPS	05-31-08
		President of WPS	02-21-07
		President and Chief Operating Officer – Generation – WPS	08-15-04
Thomas P. Meinz	63	Executive Vice President and Chief External Affairs Officer	05-15-08
		Executive Vice President – External Affairs	02-21-07
		Executive Vice President – Public Affairs	09-12-04
Phillip M. Mikulsky	61	Executive Vice President – Corporate Development and Shared Services	09-21-08
		Executive Vice President and Chief Development Officer	02-21-07
		Executive Vice President – Development	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	02-21-07
		Vice President – Controller and Chief Accounting Officer	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	07-31-07
		Vice President – Legal Services and Chief Compliance Officer – IBS	02-21-07
		Secretary and Manager – Legal Services	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	04-05-09
		President and Chief Operating Officer – Integrys Gas Group [(2)]	02-21-07
		President and Chief Operating Officer – Energy Delivery – WPS	08-15-04
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 5. MARKET FOR INTEGRYS ENERGY GROUP'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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

Share Data	Dividends Per Share	Price Range High	Price Range 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 DATA

INTEGRYS 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.

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.

RESULTS OF OPERATIONS

(Millions, except per share amounts)	Year Ended December 31 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.

<u>**Financial Results – 2008 Compared with 2007**</u>

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

(Millions, except degree days)	Year Ended December 31 2009	2008	2007	Change in 2009 Over 2008	Change in 2008 Over 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					
Average heating degree days	**7,061**	7,257	N/M [3]	(2.7)%	N/A

[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.

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.

  - 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:

- 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

<u>*Revenues*</u>

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

(Millions, except degree days)	Year Ended December 31 2009	2008	2007	Change in 2009 Over 2008	Change in 2008 Over 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.

<u>*Margins*</u>

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.

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.

(Millions, except natural gas sales volumes)	Year Ended December 31 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.

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

$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.

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 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 2009	2008	2007	Change in 2009 Over 2008	Change in 2008 Over 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.

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.

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
Integrys Energy Group		
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
WPS		
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
PEC		
Issuer credit rating	BBB+	N/A
Senior unsecured debt	BBB	Baa1
PGL		
Issuer credit rating	BBB+	A3
Senior secured debt	A-	A2
Commercial paper	A-2	P-2
NSG		
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 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.