

INTEGRYS ENERGY GROUP, INC.
Form 10-Q
November 05, 2009

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

FORM 10-Q

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

For the quarterly period ended September 30, 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, 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 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 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.

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Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

Yes No

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

Common stock, \$1 par value,
76,420,113 shares outstanding at
November 3, 2009

INTEGRYS ENERGY GROUP, INC.
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2009

TABLE OF CONTENTS

	Page
COMMONLY USED <u>ACRONYMS</u>	3
<u>FORWARD-LOOKING STATEMENTS</u>	4
PART I. FINANCIAL INFORMATION	6
Item 1. FINANCIAL STATEMENTS (Unaudited)	6
Condensed Consolidated Statements of <u>Income</u>	6
Condensed Consolidated <u>Balance Sheets</u>	7
Condensed Consolidated Statements of <u>Cash Flows</u>	8
CONDENSED <u>NOTES</u> TO FINANCIAL STATEMENTS OF Integrys Energy Group, Inc. and Subsidiaries	9 – 46
	Page
Note 1 Financial Information	9
Note 2 Cash and Cash Equivalents	9
Note 3 Risk Management Activities	10
Note 4 Integrys Energy Services Strategy Change	15
Note 5 Discontinued Operations	16
Note 6 Investment in ATC	17
Note 7 Inventories	17
Note 8 Goodwill and Other Intangible Assets	18
Note 9 Short-Term Debt and Lines of Credit	20
Note 10 Long-Term Debt	21
Note 11 Asset Retirement Obligations	22
Note 12 Income Taxes	22
Note 13 Commitments and Contingencies	23
Note 14 Guarantees	31
Note 15 Employee Benefit Plans	32
Note 16 Stock-Based Compensation	33
Note 17 Comprehensive Income (Loss)	35
Note 18 Common Equity	35
Note 19 Fair Value	37
Note 20 Miscellaneous Income	39
Note 21 Regulatory Environment	39
Note 22 Segments of Business	43
Note 23 New Accounting Pronouncements	46
<u>Item 2.</u> Management's Discussion and Analysis of Financial Condition and Results of Operations	47 – 79

<u>Item 3.</u>	Quantitative and Qualitative Disclosures About Market Risk	80
<u>Item 4.</u>	Controls and Procedures	81

<u>PART II.</u>	OTHER INFORMATION	82
Item 1.	Legal Proceedings	82
Item 1A.	Risk Factors	82
Item 6.	Exhibits	82
<u>Signature</u>		83

EXHIBIT 84
INDEX

3.1	Amendments to the By-Laws of Integrys Energy Group, Inc. effective September 17, 2009 (Incorporated by reference to Exhibit 3.1 to Integrys Energy Group’s Form 8-K filed September 21, 2009)
3.2	Integrys Energy Group, Inc. By-Laws as in effect at September 17, 2009 (Incorporated by reference to Exhibit 3.2 to Integrys Energy Group’s Form 8-K filed September 21, 2009)
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, Inc.
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, Inc.
32	Written Statement of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 for Integrys Energy Group, Inc.

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 risk factors 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, 2008, 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 and future initiatives to address concerns about global climate change, changes in environmental, tax, and other laws and regulations to which Integrys Energy Group and its subsidiaries are subject, as well as changes in the application of existing laws and regulations;

- Current and future litigation, regulatory investigations, proceedings, or inquiries, including, but not limited to, manufactured gas plant site cleanup, reconciliation of revenues from the Gas Charge (as defined in Note 13, "Commitments and Contingencies") and related natural gas costs, and the proceeding regarding the Weston 4 air permit;

- 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 associated with executing Integrys Energy Group's plan to significantly reduce the scope and scale of, or divest in its entirety, the nonregulated energy services 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;
Advances in technology;
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 and the use of financial and derivative instruments;
The risks associated with the inability of Integrys Energy Group's and its subsidiaries' counterparties, affiliates, and customers to meet their obligations;

Weather and other natural phenomena, in particular the effect of weather on natural gas and electricity sales;
The utilization of tax credit and loss carryforwards;
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)

(Millions, except per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Nonregulated revenues	\$ 754.0	\$ 2,543.0	\$ 3,355.3	\$ 7,556.4
Utility revenues	543.8	680.1	2,570.9	3,073.1
Total revenues	1,297.8	3,223.1	5,926.2	10,629.5
Nonregulated cost of fuel, natural gas, and purchased power	661.7	2,640.9	3,139.7	7,470.2
Utility cost of fuel, natural gas, and purchased power	220.6	338.0	1,402.6	1,927.6
Operating and maintenance expense	238.4	242.3	805.7	780.7
Goodwill impairment loss	-	-	291.1	6.5
Restructuring expense	2.4	-	21.5	-
Depreciation and amortization expense	57.5	56.7	172.0	163.8
Taxes other than income taxes	23.9	21.4	72.5	69.1
Operating income (loss)	93.3	(76.2)	21.1	211.6
Miscellaneous income	25.9	23.7	67.9	64.5
Interest expense	(41.7)	(39.5)	(124.4)	(110.9)
Other expense	(15.8)	(15.8)	(56.5)	(46.4)
Income (loss) before taxes	77.5	(92.0)	(35.4)	165.2
Provision (benefit) for income taxes	28.0	(33.6)	59.3	62.2
Net income (loss) from continuing operations	49.5	(58.4)	(94.7)	103.0
Discontinued operations, net of tax	2.3	-	2.6	0.1
Net income (loss)	51.8	(58.4)	(92.1)	103.1
Preferred stock dividends of subsidiary	0.7	0.7	2.3	2.3
Net income (loss) attributed to common shareholders	\$ 51.1	\$ (59.1)	\$ (94.4)	\$ 100.8
Average shares of common stock				
Basic	76.8	76.7	76.8	76.5
Diluted	76.9	76.7	76.8	76.9
Earnings (loss) per common share (basic)				
Net income (loss) from continuing operations	\$ 0.64	\$ (0.77)	\$ (1.26)	\$ 1.32

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Discontinued operations, net of tax	0.03	-	0.03	-
Earnings (loss) per common share (basic)	\$ 0.67	\$ (0.77)	\$ (1.23)	\$ 1.32
Earnings (loss) per common share (diluted)				
Net income (loss) from continuing operations	\$ 0.63	\$ (0.77)	\$ (1.26)	\$ 1.31
Discontinued operations, net of tax	0.03	-	0.03	-
Earnings (loss) per common share (diluted)	\$ 0.66	\$ (0.77)	\$ (1.23)	\$ 1.31
Dividends per common share declared	\$ 0.68	\$ 0.67	\$ 2.04	\$ 2.01

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

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited) (Millions)	September 30 2009	December 31 2008
Assets		
Cash and cash equivalents	\$ 149.4	\$ 254.1
Accounts receivable and accrued unbilled revenues, net of reserves of \$71.1 and \$62.5, respectively	926.3	2,155.3
Inventories	414.9	722.8
Assets from risk management activities	2,045.3	1,991.8
Regulatory assets	117.4	244.0
Assets held for sale	-	270.5
Deferred income taxes	169.0	-
Other current assets	203.1	280.8
Current assets	4,025.4	5,919.3
Property, plant, and equipment, net of accumulated depreciation of \$2,839.8 and \$2,710.0, respectively	4,915.1	4,773.3
Regulatory assets	1,452.6	1,444.8
Assets from risk management activities	1,016.1	730.2
Goodwill	642.8	933.9
Other long-term assets	513.2	471.0
Total assets	\$ 12,565.2	\$ 14,272.5
Liabilities and Shareholders' Equity		
Short-term debt	\$ 86.0	\$ 1,209.0
Current portion of long-term debt	271.0	155.2
Accounts payable	640.0	1,534.3
Liabilities from risk management activities	2,125.5	1,967.9
Regulatory liabilities	107.9	58.8
Liabilities held for sale	-	253.8
Deferred income taxes	-	71.6
Other current liabilities	420.7	494.8
Current liabilities	3,651.1	5,745.4
Long-term debt	2,396.7	2,288.0
Deferred income taxes	648.2	435.7
Deferred investment tax credits	35.9	36.9
Regulatory liabilities	279.9	275.5
Environmental remediation liabilities	643.9	640.6
Pension and other postretirement benefit obligations	645.9	636.5
Liabilities from risk management activities	1,000.0	731.3
Asset retirement obligations	187.4	179.1
Other long-term liabilities	148.6	152.8
Long-term liabilities	5,986.5	5,376.4

Commitments and contingencies

Preferred stock of subsidiary - \$100 par value; 1,000,000 shares authorized; 511,882 shares issued; 510,495 shares outstanding	51.1	51.1
Common stock - \$1 par value; 200,000,000 shares authorized; 76,424,213 shares issued; 76,010,558 shares outstanding	76.4	76.4
Additional paid-in capital	2,494.2	2,487.9
Retained earnings	374.0	624.6
Accumulated other comprehensive loss	(52.6)	(72.8)
Treasury stock and shares in deferred compensation trust	(15.5)	(16.5)
Total liabilities and shareholders' equity	\$ 12,565.2	\$ 14,272.5

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

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH
FLOWS (Unaudited)

(Millions)	Nine Months Ended	
	2009	September 30 2008
Operating Activities		
Net income (loss)	\$ (92.1)	\$ 103.1
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities		
Discontinued operations, net of tax	(2.6)	(0.1)
Goodwill impairment loss	291.1	6.5
Depreciation and amortization expense	172.0	163.8
Recoveries and refunds of regulatory assets and liabilities	30.8	50.2
Net unrealized losses (gains) on nonregulated energy contracts	151.1	(37.9)
Nonregulated lower of cost or market inventory adjustments	36.0	119.5
Bad debt expense	49.7	54.6
Pension and other postretirement expense	51.0	36.6
Pension and other postretirement contributions	(30.9)	(27.0)
Deferred income taxes and investment tax credit	(32.2)	65.8
(Gain) Loss on sale of assets	(1.8)	1.5
Equity income, net of dividends	(11.9)	(11.3)
Other	(28.0)	(28.3)
Changes in working capital		
Accounts receivable and accrued unbilled revenues	1,170.5	169.8
Inventories	347.5	(696.3)
Other current assets	86.4	(95.0)
Accounts payable	(678.5)	18.5
Other current liabilities	(13.5)	(193.2)
Net cash provided by (used for) operating activities	1,494.6	(299.2)
Investing Activities		
Capital expenditures	(342.3)	(355.2)
Proceeds from the sale or disposal of assets	37.9	9.2
Purchase of equity investments	(23.9)	(27.6)
Cash paid for transmission interconnection	-	(17.4)
Proceeds received from transmission interconnection	-	99.7
Other	(9.9)	4.0
Net cash used for investing activities	(338.2)	(287.3)
Financing Activities		
Short-term debt, net	(951.9)	632.1
Redemption of notes payable	(157.9)	-

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Proceeds from sale of borrowed natural gas	148.6	402.6
Purchase of natural gas to repay natural gas loans	(370.1)	(221.8)
Issuance of long-term debt	230.0	-
Repayment of long-term debt	(2.0)	(54.7)
Payment of dividends		
Preferred stock of subsidiary	(2.3)	(2.3)
Common stock	(155.2)	(152.9)
Other	(4.8)	(2.3)
Net cash (used for) provided by financing activities	(1,265.6)	600.7
Change in cash and cash equivalents - continuing operations	(109.2)	14.2
Change in cash and cash equivalents - discontinued operations		
Net cash provided by investing activities	4.5	-
Change in cash and cash equivalents	(104.7)	14.2
Cash and cash equivalents at beginning of period	254.1	41.2
Cash and cash equivalents at end of period	\$ 149.4	\$ 55.4

The accompanying condensed notes are an integral part of these statements

INTEGRYS ENERGY GROUP, INC. AND SUBSIDIARIES
 CONDENSED NOTES TO FINANCIAL STATEMENTS
 September 30, 2009

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, 2008.

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. Subsequent events at Integrys Energy Group were evaluated for potential recognition or disclosure through November 4, 2009, which is the date the financial statements were issued. 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, 2009.

Integrys Energy Group adopted SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements," (now incorporated as part of FASB ASC 810-10) as of January 1, 2009. This standard clarifies that noncontrolling interests should be reported in equity and that net income or loss should include amounts attributable to both common shareholders and noncontrolling interests. As a result, Integrys Energy Group changed the presentation of the preferred stock dividends of WPS, a subsidiary of Integrys Energy Group, on the Condensed Consolidated Statements of Income for all periods presented. After adoption of the standard, these subsidiary preferred stock dividends are included below net income or loss in the presentation of net income or loss attributed to common shareholders.

As discussed in Note 4, "Integrys Energy Services Strategy Change," Integrys Energy Group has reclassified the assets and liabilities related to its Canadian energy marketing operations at December 31, 2008 to assets and liabilities held for sale.

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:

(Millions)	Nine Months Ended September 30	
	2009	2008
Cash paid for interest	\$ 100.5	\$ 101.2
Cash paid for income taxes	25.2	123.1

Significant non-cash transactions were:

Nine Months Ended
September 30

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(Millions)	2009	2008
Construction costs funded through accounts payable	\$ 26.2	\$ 38.0
Intangible assets (customer contracts) received in exchange for risk management assets	17.0	-

-9-

NOTE 3--RISK MANAGEMENT ACTIVITIES

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

(Millions)	Balance Sheet Presentation *	Risk Management Assets		Risk Management Liabilities	
		September 30 2009	December 31 2008	September 30 2009	December 31 2008
Utility Segments					
Non-hedge derivatives					
Commodity contracts	Current	\$ 23.2	\$ 28.6	\$ 45.5	\$ 161.6
Commodity contracts	Long-term	3.9	-	1.1	9.0
Cash flow hedges					
Commodity contracts	Current	0.2	-	0.5	1.5
Commodity contracts	Long-term	-	-	-	-
Nonregulated Segments					
Non-hedge derivatives					
Commodity contracts	Current	2,007.4	1,849.6	2,022.5	1,722.6
Commodity contracts	Long-term	1,008.2	721.6	981.7	699.8
Interest rate swaps	Current	-	-	1.3	1.0
Interest rate swaps	Long-term	-	-	2.9	3.3
Foreign exchange contracts	Current	1.4	2.2	1.0	0.3
Foreign exchange contracts	Long-term	1.3	2.4	1.2	0.8
Fair value hedges					
Commodity contracts	Current	-	14.2	-	-
Interest rate swaps	Current	1.8	1.1	-	-
Interest rate swaps	Long-term	0.7	2.1	-	-
Cash flow hedges					
Commodity contracts	Current	11.3	81.3	51.8	79.4
Commodity contracts	Long-term	2.0	4.1	13.1	14.8
Interest rate swaps	Current	-	-	2.9	1.5
Interest rate swaps	Long-term	-	-	-	3.6
Foreign exchange contracts	Current	-	14.8	-	-
Total		\$ 3,061.4	\$ 2,722.0	\$ 3,125.5	\$ 2,699.2

* All derivatives are recognized on the balance sheet at their fair value unless they qualify for the normal purchases and sales exception found in FASB ASC 815. 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 assets and liabilities from risk management activities classified as held for sale at December 31, 2008. For more information see Note 4, "Integrys Energy Services Strategy Change."

(Millions)	Balance Sheet Presentation *	Assets Held For Sale	Liabilities Held For Sale
Nonregulated Segments			

Non-hedge derivatives					
Commodity contracts	Current	\$	231.3	\$	222.2
Commodity contracts	Long-term		28.4		29.9
Foreign exchange contracts	Current		0.6		0.2
Foreign exchange contracts	Long-term		0.1		1.5
Total		\$	260.4	\$	253.8

* These risk management assets and liabilities were classified as current or long-term at December 31, 2008. At September 30, 2009, they were reclassified to assets and liabilities held for sale, all in the current section of the balance sheet.

FASB ASC 815-10-45 provides the option to present certain asset and liability derivative positions net on the balance sheet and to net the related cash collateral against these net derivative positions. Integrys

Energy Group elected not to net these items in its Condensed Consolidated Balance Sheets. The following table shows Integrys Energy Group's cash collateral positions:

(Millions)	September 30, 2009	December 31, 2008
Cash collateral provided to others	\$ 238.6	\$ 256.4
Cash collateral received from others	90.9	18.9

On the Condensed Consolidated Balance Sheets, the cash collateral provided to others is reflected in accounts receivable and accrued unbilled revenues, and the cash collateral received from others is reflected in other current liabilities.

Certain of Integrys Energy Group's derivative and nonderivative commodity instruments contain provisions that could require 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 credit-risk related contingent features that were in a liability position at September 30, 2009, was \$1,918.0 million. As of September 30, 2009, Integrys Energy Group had not posted any cash collateral related to the credit-risk related contingent features of these commodity instruments.

If all of the credit-risk related contingent features contained in commodity instruments (including derivatives, non-derivatives, normal purchase and normal sales contracts, and applicable payables and receivables) had been triggered at September 30, 2009, Integrys Energy Group would have been required to post collateral of \$644.8 million. Of this \$644.8 million, Integrys Energy Group had already satisfied \$203.9 million with letters of credit. Therefore, the remaining collateral requirement would have been \$440.9 million.

Utility Segments

Non-Hedge Derivatives

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

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

(Millions)	Financial Statement Presentation	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009
Commodity contracts	Balance Sheet – Regulatory assets (current)	\$ 54.5	\$ 109.1
Commodity contracts	Balance Sheet – Regulatory assets (long-term)	4.7	9.0
Commodity contracts	Balance Sheet – Regulatory liabilities (current)	(4.6)	3.1
Commodity contracts	Balance Sheet – Regulatory liabilities (long-term)	(0.8)	(0.7)
Commodity contracts	Income Statement – Utility cost of fuel, natural gas, and purchased power	0.1	0.3
Commodity contracts	Income Statement – Operating and maintenance expense	(0.1)	0.1

At September 30, 2009, the utilities had the following notional volumes of outstanding non-hedge derivative contracts:

	Purchases	Other Transactions
Natural gas (millions of therms)	615.1	N/A
FTRs (millions of kilowatt-hours)	N/A	7,867.6
Petroleum products (barrels)	24,896	N/A

Cash Flow Hedges

PGL uses commodity contracts designated as cash flow hedges to hedge changes in the price of natural gas used to support operations. These contracts extend through December 2011. At September 30, 2009, PGL had the following notional volumes of outstanding contracts that were designated as cash flow hedges:

	Purchases
Natural gas (millions of therms)	10.8

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

(Millions)	Unrealized Gain (Loss) Recognized in OCI on Derivative Instrument (Effective Portion)			
	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Commodity contracts	\$ 0.2	\$ (2.9)	\$ (1.0)	\$ 0.1

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

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(Millions)	Income Statement Presentation	Three Months Ended		Nine Months Ended	
		September 30		September 30	
		2009	2008	2009	2008
	Operating and maintenance				
	Settled commodity contracts expense	\$ (0.8)	\$ 0.3	\$ (2.2)	\$ 0.6

The amount reclassified from accumulated OCI into earnings as a result of the discontinuance of cash flow hedge accounting for certain hedge transactions was not significant for the three and nine months ended September 30, 2009, and 2008. Cash flow hedge ineffectiveness related to these commodity contracts was not significant for the three and nine months ended September 30, 2009, and 2008. When testing for effectiveness, no portion of the derivative instruments was excluded. In the next 12 months, PGL expects that an insignificant pre-tax loss will be recognized in earnings as the hedged transactions occur.

Nonregulated Segments

Non-Hedge Derivatives

IntegrYS Energy Group's nonregulated segments enter into derivative contracts such as futures, forwards, options, and swaps that are not designated as accounting hedges under GAAP. In most cases, these contracts are used to manage commodity price risk associated with customer related contracts, interest rate risk associated with expected future natural gas purchases, and foreign currency exchange rate risk related to the wrap up of the Canadian marketing operations. In very limited circumstances, IntegrYS Energy Services may also enter into non-hedge derivative contracts to take advantage of opportunities and inefficiencies in the natural gas and electric energy markets unrelated to its customer positions to profit on price movements.

At September 30, 2009, the nonregulated segments had the following notional volumes of outstanding non-hedge derivative contracts:

(Millions)	Purchases	Sales	Other Transactions
Commodity contracts			
Natural gas (therms)	4,510.9	4,548.6	N/A
Power (kilowatt-hours)	145,162.9	139,173.2	N/A
Interest rate swaps	N/A	N/A	\$ 240.6
Foreign exchange contracts	\$ 42.6	\$ 46.5	N/A

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

(Millions)	Income Statement Presentation	Gain (Loss) During	
		Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009
Commodity contracts	Nonregulated revenue	\$ 19.0	\$ (9.8)
	Nonregulated revenue (reclassified from accumulated OCI)	(0.3)	(2.3)
Commodity contracts		(0.3)	(2.3)
Interest rate swaps	Interest expense	(0.8)	(0.5)
Foreign exchange contracts	Nonregulated revenue	(0.7)	(1.8)
Total		\$ 17.2	\$ (14.4)

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.

(Millions)	Income Statement Presentation	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009

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Interest rate swap	Interest expense	\$	(0.4)	\$	(0.7)
Debt hedged by swap	Interest expense		0.4		0.7
Total		\$	-	\$	-

Fair value hedge ineffectiveness recorded in interest expense on the Condensed Consolidated Statements of Income was not significant for the three and nine months ended September 30, 2009, and 2008. No amounts were excluded from effectiveness testing related to the interest rate swap during the three and nine months ended September 30, 2009, and 2008.

During the nine months ended September 30, 2009, Integrys Energy Services did not have any commodity derivative contracts designated as fair value hedges. During the nine months ended September 30, 2008, Integrys Energy Services had commodity derivative contracts designated as fair value hedges to mitigate the risk of changes in the price of natural gas held in storage. Fair value hedge ineffectiveness recorded in nonregulated revenue on the Condensed Consolidated Statements of Income was not significant for the three months ended September 30, 2008, and was a pre-tax loss of \$2.8 million for the nine months ended September 30, 2008. 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 loss of \$2.5 million during the three months ended September 30, 2008, and was not significant during the nine months ended September 30, 2008.

Cash Flow Hedges

Commodity futures, forwards, and swaps that are designated as cash flow hedges extend through April 2014, and are used to mitigate the risk of cash flow variability associated with future purchases and sales of natural gas and electricity. Integrys Energy Group also has two interest rate swaps that are designated as cash flow hedges to fix the interest rate on an unsecured term loan through June 2010. At September 30, 2009, the nonregulated segments had the following notional volumes of outstanding contracts that were designated as cash flow hedges:

(Millions)	Purchases	Sales	Other Transactions
Commodity contracts			
Natural gas (therms)	62.2	53.8	N/A
Power (kilowatt-hours)	6.8	-	N/A
Interest rate swaps	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. In March 2009, Integrys Energy Group settled two forward foreign currency exchange contracts that were designated as cash flow hedges to mitigate the variability in the foreign currency exposure of a fixed rate Japanese yen denominated term loan that matured in March 2009. The tables below show the amounts related to cash flow hedges recorded in OCI and in earnings.

(Millions)	Unrealized Gain (Loss) Recognized in OCI on Derivative Instrument (Effective Portion)			
	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Commodity contracts	\$ (7.1) *	\$ 67.7	\$ (57.6) *	\$ 33.8
Interest rate swaps	0.7	0.2	2.2	0.5

*In the second and third quarters of 2009, cash flow hedge accounting was discontinued for certain transactions, as management made the assessment that these transactions were no longer probable of occurring. During the three months ended September 30, 2009, unrealized gains of \$6.7 million were recognized in OCI related to these transactions, bringing the total to \$6.4 million for 2009. In accordance with FASB ASC 815, the amount recorded in OCI is amortized to earnings over the term of the contracts.

Income Statement	Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	
	Nine Months Ended	

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(Millions)	Presentation	Three Months Ended		September 30	
		September 30 2009	2008	2009	2008
Settled/Realized					
Commodity contracts	Nonregulated revenue	\$ (42.2)	\$ 78.1	\$ (79.3)	\$ 63.9
Interest rate swaps	Interest expense	0.3	0.3	0.9	0.9
Hedge Designation Discontinued					
Commodity contracts	Nonregulated revenue	0.1	0.3	(0.3)	(2.6)
Total		\$ (41.8)	\$ 78.7	\$ (78.7)	\$ 62.2

(Millions)	Income Statement Presentation	Gain (Loss) Recognized in Income on Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing)			
		Three Months Ended		Nine Months Ended	
		September 30		September 30	
		2009	2008	2009	2008
Commodity contracts	Nonregulated revenue	\$ 0.4	\$ 3.5	\$ (0.9)	\$ -

In the next 12 months, subject to changes in market prices of natural gas and electricity, a pre-tax loss of \$51.7 million related to cash flow hedges of commodity contracts is expected to be recognized in earnings as the hedged transactions occur. This amount is expected to be substantially offset by the settlement of the related nonderivative hedged contracts.

NOTE 4--INTEGRYS ENERGY SERVICES STRATEGY CHANGE

Restructuring Costs

Integrys Energy Group has decided 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. In connection with this strategy, the following restructuring costs were expensed:

(Millions)		Three Months Ended September 30, 2009		Nine Months Ended September 30, 2009
Employee-related costs	\$	0.3	\$	11.1
Software write-offs and accelerated depreciation		0.2		5.4
Legal and consulting		1.7		4.7
Miscellaneous		0.2		0.3
Total restructuring costs	\$	2.4	\$	21.5

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.

Integrys Energy Group expects to incur total employee-related restructuring costs of approximately \$20 million to \$26 million by the end of 2010, including the \$11.1 million accrued as of September 30, 2009. As of September 30, 2009, none of these employee-related restructuring costs had been paid.

Sale of Canadian Natural Gas and Electric Power Portfolio

In September 2009, Integrys Energy Services of Canada, a subsidiary of Integrys Energy Services, sold nearly all of its Canadian natural gas and electric power contract portfolio. In a separate transaction, Integrys Energy Services of Canada transferred a 2-bcf natural gas storage contract to a counterparty. With these two transactions, Integrys Energy Services exited the majority of its electric and natural gas marketing business in Canada.

The following table shows the carrying values of the major classes of assets and liabilities included in the transactions at the closing dates and classified as held for sale at December 31, 2008.

(Millions)	As of the		December 31, 2008
	Closing Dates		
Inventories	\$	5.3	\$ 10.1
Current risk management assets		134.7	231.9
Long-term risk management assets		48.6	28.5
Total assets	\$	188.6	\$ 270.5
Current risk management liabilities	\$	119.8	\$ 222.4
Long-term risk management liabilities		32.3	31.4
Total liabilities	\$	152.1	\$ 253.8

Proposed Sale of United States Wholesale Natural Gas Marketing Business

In October 2009, Integrys Energy Services signed an agreement to sell its United States wholesale natural gas marketing business in a two-part transaction. The closing is contingent upon obtaining certain customary contractual consents and necessary regulatory approvals. The first part of this transaction involves substantially all of Integrys Energy Services' wholesale natural gas marketing business and is anticipated to close in the fourth quarter of 2009. The second part of this transaction includes wholesale natural gas storage contracts. Certain of these storage contracts are expected to be sold by the end of the first quarter of 2010. Integrys Energy Services will provide fee-based services to the buyer of the wholesale natural gas marketing business utilizing the remaining storage contracts through April 2011 and will sell those contracts upon completion of the services at that time.

As of September 30, 2009, the wholesale natural gas marketing business did not meet the criteria to be reported as held for sale. The carrying values of the major classes of assets and liabilities included in the sale agreement were as follows:

(Millions)	September 30, 2009	
Inventories	\$	27.0
Current risk management assets		268.4
Long-term risk management assets		59.9
Total assets	\$	355.3
Accounts payable	\$	73.6
Current risk management liabilities		282.7
Long-term risk management liabilities		66.2
Total liabilities	\$	422.5

NOTE 5--DISCONTINUED OPERATIONS

Energy Management Consulting Business

In July 2009, Integrys Energy Services completed the sale of its energy management consulting business for \$4.5 million. This business provided consulting services relating to long-term strategies for managing energy costs for its customers. 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 \$3.8 million (\$2.3 million after tax).

WPS Niagara Generation, LLC

During the nine months ended September 30, 2009, Integrys Energy Services recorded a \$0.3 million after-tax gain in discontinued operations related to a refund received in connection with the overpayment of auxiliary power service in prior years.

-16-

During the nine months ended September 30, 2008, Integrys Energy Services recorded a \$0.1 million after-tax gain in discontinued operations related to amortization of an environmental indemnification guarantee included as part of the sale agreement.

NOTE 6--INVESTMENT IN ATC

Integrys Energy Group had an approximate 34% ownership interest in ATC at September 30, 2009. 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 and nine months ended September 30, 2009. Integrys Energy Group's investment in ATC is recorded in other long-term assets on the Condensed Consolidated Balance Sheets.

(Millions)	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2009	
Balance at the beginning of period	\$	369.2	\$	346.9
Equity in net income		19.3		55.7
Capital contributions		8.5		23.9
Dividends received		(15.2)		(44.7)
Balance at the end of period	\$	381.8	\$	381.8

ATC's financial data is included in the following tables:

(Millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Income statement data				
Revenues	\$	132.3	\$	119.9
Operating expenses		58.7		52.0
Other expense		19.8		18.2
Net income *	\$	53.8	\$	49.7
			\$	157.4
			\$	137.8

* 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)	September 30, 2009		December 31, 2008	
Balance sheet data				
Current assets	\$	48.2	\$	50.8
Noncurrent assets		2,729.9		2,480.0
Total assets	\$	2,778.1	\$	2,530.8
Current liabilities	\$	286.2	\$	252.0
Long-term debt		1,259.6		1,109.4
Other noncurrent liabilities		78.8		120.2
Members' equity		1,153.5		1,049.2
Total liabilities and members' equity	\$	2,778.1	\$	2,530.8

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. At September 30, 2009, all LIFO layers were replenished and the LIFO liquidation balance was zero.

-17-

NOTE 8--GOODWILL AND OTHER INTANGIBLE ASSETS

Integrys Energy Group had the following changes to the carrying amount of goodwill for the nine months ended September 30, 2009:

(Millions)	Natural Gas Utility Segment	Integrys Energy Services	Total
Goodwill recorded at December 31, 2008	\$ 927.0	\$ 6.9	\$ 933.9
Impairment loss	(291.1)	-	(291.1)
Goodwill recorded at September 30, 2009	\$ 635.9	\$ 6.9	\$ 642.8

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, which are Integrys Energy Group's reporting units containing 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. 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. This impairment related to MGU and MERC (acquired in 2006) and PGL and NSG (acquired in 2007). 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. No further goodwill impairments were identified during annual testing procedures performed during the second quarter of 2009.

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

(Millions)	September 30, 2009			December 31, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Amortized intangible assets (liabilities)						
Customer-related (1)	\$ 32.6	\$ (17.3)	\$ 15.3	\$ 32.6	\$ (14.2)	\$ 18.4
Natural gas and electric contract assets (2) (3)	76.0	(60.6)	15.4	60.1	(54.6)	5.5
Natural gas and electric contract liabilities (2) (4)	(33.6)	25.2	(8.4)	(33.6)	20.2	(13.4)
Renewable energy credits (5)	3.3	(2.0)	1.3	3.4	(2.1)	1.3
Nonregulated easements (6)	3.5	(0.1)	3.4	-	-	-
Emission allowances (7)	2.1	(0.1)	2.0	2.3	(0.1)	2.2
Other	4.2	(1.1)	3.1	3.0	(1.0)	2.0
Total	88.1	(56.0)	32.1	67.8	(51.8)	16.0
Unamortized intangible assets						
MGU trade name	5.2	-	5.2	5.2	-	5.2

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Total intangible assets	\$	93.3	\$	(56.0)	\$	37.3	\$	73.0	\$	(51.8)	\$	21.2
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(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

-18-

amortization period for customer-related intangible assets at September 30, 2009, was approximately seven 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, 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 \$7.3 million and \$8.1 million, respectively, at September 30, 2009, and \$3.1 million and \$2.4 million, respectively, at December 31, 2008. The remaining weighted-average amortization period for these intangible assets at September 30, 2009, was 3.3 years.
- (4) Includes both short-term and long-term intangible liabilities related to customer contracts in the amount of \$3.6 million and \$4.8 million, respectively, at September 30, 2009, and \$6.0 million and \$7.4 million, respectively, at December 31, 2008. The remaining weighted-average amortization period for these intangible liabilities at September 30, 2009, was 3.1 years.
- (5) Used at Integrys Energy Services to comply with state Renewable Portfolio Standards, as well as for trading purposes.
- (6) 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 14.75 years.
- (7) Emission allowances do not have a contractual term or expiration date.

Intangible asset amortization, 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 September 30, 2009, and 2008, was \$1.5 million and \$2.1 million, respectively. Amortization for the nine months ended September 30, 2009, and 2008, was \$4.5 million and \$5.8 million, respectively.

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

(Millions)	
For year ending December 31, 2009	\$ 1.6
For year ending December 31, 2010	4.0
For year ending December 31, 2011	3.4
For year ending December 31, 2012	2.4
For year ending December 31, 2013	1.7

Amortization of the natural gas and electric contract intangible assets and liabilities were recorded as a component of nonregulated cost of fuel, natural gas, and purchased power. Amortization of these contracts for the three months ended September 30, 2009, and 2008, resulted in an increase to nonregulated cost of fuel, natural gas, and purchased power of \$2.4 million and \$0.2 million, respectively. Amortization of these contracts resulted in an increase to nonregulated cost of fuel, natural gas, and purchased power of \$2.1 million for the nine months ended September 30, 2009, and \$10.3 million for the nine months ended September 30, 2008.

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

(Millions)

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For year ending December 31, 2009	\$	1.4
For year ending December 31, 2010		3.1
For year ending December 31, 2011		0.8
For year ending December 31, 2012		0.8
For year ending December 31, 2013		0.6

-19-

NOTE 9--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.

(Millions, except percentages)	September 30, 2009	December 31, 2008
Commercial paper outstanding	\$ 76.0	\$ 552.9
Average discount rate on outstanding commercial paper	0.44%	4.78%
Borrowings under revolving credit facilities	-	\$ 475.0
Average interest rate on outstanding borrowings under revolving credit facilities	-	2.41%
Short-term notes payable outstanding	\$ 10.0	\$ 181.1
Average interest rate on outstanding short-term notes payable	0.21%	3.40%

The commercial paper at September 30, 2009, had varying maturity dates ranging from October 1, 2009, through October 23, 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:

(Millions)	Maturity	September 30, 2009	December 31, 2008
Revolving credit facility (Integrys Energy Group) (1)	6/02/10	\$ 500.0	\$ 500.0
Revolving credit facility (Integrys Energy Group) (1)	6/09/11	500.0	500.0
Revolving credit facility (Integrys Energy Group) (2)	5/03/09	-	250.0
Revolving credit facility (Integrys Energy Group) (3)	5/26/10	425.0	-
Revolving credit facility (Integrys Energy Group) (4)	6/04/10	35.0	-
Revolving credit facility (WPS) (5)	6/02/10	115.0	115.0
Revolving credit facility (PEC) (1) (6)	6/13/11	400.0	400.0
Revolving credit facility (PGL) (7)	7/12/10	250.0	250.0
Revolving credit facility (Integrys Energy Services) (8)	6/29/09	-	175.0
Revolving short-term notes payable (WPS) (9)	5/13/10	10.0	10.0
Short-term notes payable (Integrys Energy Group) (10)	3/30/09	-	171.1
Total short-term credit capacity		2,235.0	2,371.1
Less:			
Letters of credit issued inside credit facilities		292.8	414.6
Loans outstanding under credit agreements and notes payable		10.0	656.1
Commercial paper outstanding		76.0	552.9
Accrued interest or original discount on outstanding commercial paper		-	0.8
Available capacity under existing agreements		\$ 1,856.2	\$ 746.7

(1) Provides support for Integrys Energy Group's commercial paper borrowing program.

(2) This facility matured in May 2009, and the revolving credit agreement was terminated.

- (3) In May 2009, Integrys Energy Group entered into a revolving credit agreement to provide support for Integrys Energy Group's commercial paper borrowing program.
- (4) In June 2009, Integrys Energy Group entered into a revolving credit agreement to provide support for Integrys Energy Group's commercial paper borrowing program.
- (5) Provides support for WPS's commercial paper borrowing program.
- (6) Borrowings under this agreement are guaranteed by Integrys Energy Group.
- (7) Provides support for PGL's commercial paper borrowing program.
- (8) This facility matured in June 2009, at which time the borrowings were paid in full, and the revolving credit agreement was terminated. This facility was previously guaranteed by Integrys Energy Group.
- (9) This note is renewed every six months and is used for general corporate purposes.

(10) This facility matured in March 2009, at which time the borrowings were paid in full, and the short-term debt agreement was terminated.

At September 30, 2009, Integrys Energy Group and its subsidiaries were in compliance with all financial covenants related to outstanding short-term debt. 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.

NOTE 10--LONG-TERM DEBT

(Millions)	September 30, 2009	December 31, 2008
WPS	\$ 872.1	\$ 872.1
UPPCO (1)	11.7	11.7
PEC	327.4	328.2
PGL (2)	576.0	501.0
NSG	75.3	75.3
Integrys Energy Group (3)	705.0	550.0
Unsecured term loan – Integrys Energy Group (4)	65.6	65.6
Term loans – nonrecourse, collateralized by nonregulated assets (5)	4.6	6.6
Other term loan (6)	27.0	27.0
Total	2,664.7	2,437.5
Unamortized discount and premium on bonds and debt	3.0	5.7
Total debt	2,667.7	2,443.2
Less current portion	(271.0)	(155.2)
Total long-term debt	\$ 2,396.7	\$ 2,288.0

(1) Prior to November 1, 2009, 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 Sheet at September 30, 2009.

(2) 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 September 30, 2009 was 0.9% for these bonds.

In March 2010, \$50.0 million of PGL's First and Refunding Mortgage Bonds will mature. As a result, these notes are included in the current portion of long-term debt on Integrys Energy Group's Condensed Consolidated Balance Sheet at September 30, 2009.

In September 2009, PGL issued \$75.0 million of Series UU, 4.63%, 10-year First and Refunding Mortgage Bonds due September 1, 2019. The net proceeds from the issuance of these bonds were used for general corporate utility purposes and to increase liquidity. The first and refunding mortgage Bonds were sold in a private placement and are not registered under the Securities Act of 1933.

(3) In June 2009, Integrys Energy Group issued \$100.0 million of 7.27%, 5-year Unsecured Senior Notes due June 1, 2014 and \$55.0 million of 8.0%, 7-year Unsecured Senior Notes due June 1, 2016. The net proceeds from the issuance of the Senior Notes were used to refinance existing short-term debt and for general corporate purposes. The senior notes were sold in a private placement and are not registered under the Securities Act of 1933.

On November 1, 2009, \$150.0 million of Integrys Energy Group Unsecured Senior Notes matured. As a result, these notes are included in the current portion of long-term debt on Integrys Energy Group's Condensed Consolidated Balance Sheet at September 30, 2009.

- (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 Sheet at September 30, 2009.
- (5) By May 2010, \$4.6 million of nonrecourse term loans will mature. As a result, these amounts are included in the current portion of long-term debt on Integrys Energy Group's Condensed Consolidated Balance Sheet at September 30, 2009.
- (6) WPS Westwood Generation, LLC, a subsidiary of Integrys Energy Services, has outstanding \$27.0 million of Refunding Tax Exempt Bonds. The interest rate at September 30, 2009 was 4.32% for these bonds.

At September 30, 2009, 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 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 the asset retirement obligations of Integrys Energy Group through September 30, 2009.

(Millions)	Regulated Utilities	Integrys Energy Services	Total
Asset retirement obligations at December 31, 2008	\$ 178.9	\$ 0.2	\$ 179.1
Accretion	6.9	0.1	7.0
Additions and revisions to estimated cash flows	1.3	-	1.3
Asset retirement obligations at September 30, 2009	\$ 187.1	\$ 0.3	\$ 187.4

NOTE 12--INCOME TAXES

Integrys Energy Group's effective tax rate for the three and nine months ended September 30, 2009, was 36.1% and (167.5)%, respectively. The effective tax rate for the three and nine months ended September 30, 2008, was 36.5% and 37.7%, 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 nine months ended September 30, 2009, differs from 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 was not deductible for income tax purposes.

For the three and nine months ended September 30, 2009, the liability for uncertain tax positions increased \$9.4 million and \$9.2 million, respectively, due primarily to the results of IRS examinations.

In February 2009, Wisconsin Act 2 was signed into law. This act requires Integrys Energy Group and its subsidiaries to file their Wisconsin income tax return as a combined group. As a result, all of Integrys Energy Group's income is now subject to apportionment and taxation in Wisconsin, requiring an adjustment to deferred taxes under the Income Taxes Topic of the FASB ASC. This resulted in a credit adjustment to deferred taxes and an increase in income tax expense of \$1.7 million, which was recorded during 2009.

NOTE 13--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 Integrys Energy Services are to meet its obligations to deliver energy to customers.

The obligations described below are as of September 30, 2009.

The electric utility segment has obligations related to coal supply and transportation that extend through 2016 and total \$373.2 million, obligations of \$1,239.9 million for either capacity or energy related to purchased power that extend through 2027, and obligations for other commodities totaling \$13.5 million, which extend through 2013. The natural gas utility segment has obligations related to natural gas supply and transportation contracts totaling \$1,365.9 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 \$3,573.3 million. The majority of these obligations end by 2011, with obligations totaling \$247.7 million extending beyond 2011.

Integrys Energy Group also has commitments in the form of purchase orders issued to various vendors, which totaled \$543.4 million and relate to normal business operations, including construction projects.

Environmental

EPA Section 114 Request

Weston and Pulliam Plants:

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 maintenance 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.

To date, the EPA has not responded to the 2001 and 2002 filings made by WPS. 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 submitted its response in April 2008. In July 2009, WPS received an inquiry requesting clarification with respect to documents provided in the April 2008 response and the response has been submitted. In August 2009, WPS received a data request seeking further information on two specific projects at Pulliam and four at Weston. The response has been submitted.

Columbia Plant:

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 (MG&E), 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.

To date, the EPA has not responded to the 2002 filing made by WP&L. In December 2008, WP&L received an additional data request and has submitted its response. On October 10, 2009, WPS, along with its co-owners, received from the Sierra Club, a Notice of Intent to file a civil lawsuit based on allegations that major modifications were made at the Columbia generation station without complying with the Prevention of Significant Deterioration (PSD) and Title V operating permit requirements of the Clean Air Act. The allegations suggest that PSD permits that imposed Best Available Control Technology limits on emissions from the facilities should have been obtained for both the Columbia generation station, which is jointly owned by WP&L, MG&E and WPS and operated by WP&L, and another generation station solely owned by WP&L. WPS is reviewing the allegations but Integrys Energy Group is currently unable to predict the impact of the allegations on its financial position or results of operations.

Settlements with Other Utilities:

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.

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. Except as noted above for the Columbia plant, WPS has no notice of such a claim based on the information submitted to the EPA.

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.

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 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.

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. Corrective actions have been taken for the events in the three 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 financial position or 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 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, and July 2009, NOVs were issued to WPS by the WDNR that include alleged violations of the air permit at Weston 1 and 2. These NOVs are discussed above under "Weston 4 Air Permit."

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. It is not known how the WDNR will respond to the order.

Mercury and Interstate Air Quality Rules

Mercury

The State of Wisconsin revised the state mercury rule, Chapter NR 446. Phase I of the revised rule requires a 40% reduction from the 2002 through 2004 baseline mercury emissions, beginning

-25-

January 1, 2010, through the end of 2014. Beginning 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 Best Available Control Technology rule. WPS estimates capital costs of approximately \$25 million for Phase I, 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 by the EPA in 2005, the State of Wisconsin filed suit along with other states in opposition of this rule. On February 8, 2008, the United States Court of Appeals for the District of Columbia Circuit (Court of Appeals) 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 (CAIR), formerly known as the Interstate Air Quality Rule, 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. 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. CAIR 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 was forwarded to the EPA for final review.

On July 11, 2008, the Court of Appeals issued a decision vacating CAIR and the associated Federal Implementation Plan, putting the status of both CAIR nitrogen oxide allowance programs in doubt. 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, thereby, CAIR was reinstated. The Court of Appeals also 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 early 2010. As a result of the Court of Appeals' decision, CAIR is in place for 2009 and 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 \$607 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. 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. Integrys Energy Group estimated and accrued for \$642.3 million of future undiscounted investigation and cleanup costs for all sites as of September 30, 2009. 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 \$663.0 million, which is net of insurance recoveries received of \$56.8 million, related to the expected recovery of both deferred expenditures and estimated future expenditures as of September 30, 2009.

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. Operation of the groundwater treatment unit began in September 2008 and was operating at full capacity as of July 2009.

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. On February 5, 2009, the Seventh Circuit Court of Appeals stayed the appeal. The parties have executed a settlement agreement and this matter has been dismissed. The amount of the settlement is 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, resulting in subsequent flooding downstream on the Dead River, located in the Upper Peninsula of Michigan. All litigation matters have been resolved. All environmental claims have been resolved with the State of Michigan and a Consent Judgment on the environmental matters was filed and approved in June 2009.

As part of UPPCO's 2009 Power Supply Cost Recovery Plan (PSCR) filing with the MPSC, UPPCO requested recovery of the remaining deferred replacement power costs related to the Silver Lake incident. Through September 30, 2009, 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 \$0.7 million. UPPCO offset 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 was \$2.5 million at September 30, 2009.

As part of a settlement agreement with the MPSC staff and interveners in the PSCR case, UPPCO offset \$1.9 million of the remaining replacement power costs with proceeds from the sale of the Warden plant. The proceeds from the sale of the Warden plant had previously been recorded as a liability to UPPCO customers. The remaining \$0.6 million of replacement power costs was not recoverable and was recorded in operating and maintenance expense in the first quarter of 2009. This settlement has been approved by the MPSC.

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 FERC and Board of Consultants were on site and certified the completion. UPPCO received FERC approval of a refill and operations plan in February 2009. It is expected to take approximately two years to return the reservoir to normal operation. Cost recovery for rebuilding the Silver Lake facility is the subject of a current rate proceeding.

Greenhouse Gases

There is increasing concern over the issue of climate change and the effect of greenhouse gas emissions, 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 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 (such as the Waxman-Markey bill, which passed the U.S. House of Representatives, and the Kerry-Boxer draft bill which is currently being debated in the U.S. Senate), and to create national renewable portfolio standards. 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.

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 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 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 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 September 30, 2009, \$10.2 million remained unpaid, of which \$5.0 million was included in other current liabilities, and \$5.2 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 PGL and NSG believed were 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 believes that PGL and NSG have fully complied with the reconnection program obligations of the settlement agreement.

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 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. On March 31, 2009, PGL and NSG completed their responses to the 25 recommendations they agreed to implement in a June 30, 2008 response to the audit.

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.

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 July 30, 2008, the plaintiffs filed a motion for class certification and PEC responded in opposition of this motion. On October 20, 2009, the court held a hearing on the plaintiffs' motion for class certification and set November 18, 2009 as the date for ruling on the 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

-30-

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 December 2008. On March 17, 2009, the auditor issued the first quarterly interim report. The report acknowledged progress on many initiatives and restated that continual monitoring will be performed to verify sustained progress for the term of the verification phase. On June 22, 2009, the auditor issued its second quarterly interim report. The report stated that verification work has started in all but two major areas and that, while the auditors have completed verification work for only a few recommendations, PGL has made progress on many of the recommendations.

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.

NOTE 14--GUARANTEES

The following table shows outstanding guarantees at Integrys Energy Group:

(Millions)	Total Amounts Committed at September 30, 2009		Expiration		
			Less Than 1 Year	1 to 3 Years	4 to 5 Years
Guarantees supporting commodity transactions of subsidiaries (1)	\$ 1,653.4	\$ 1,294.0	\$ 233.2	\$ 37.5	\$ 88.7
Guarantees of subsidiary debt and revolving line of credit (2)	756.6	-	725.0	-	31.6
Standby letters of credit (3)	288.1	287.0	1.1	-	-
Surety bonds (4)	3.1	3.0	0.1	-	-
Other guarantees (5)	2.2	1.6	-	-	0.6
Total guarantees	\$ 2,703.4	\$ 1,585.6	\$ 959.4	\$ 37.5	\$ 120.9

(1) Consists of parental guarantees of \$1,476.8 million to support the business operations of Integrys Energy Services, which are subject to the guarantee limit discussed below; \$92.7 million and \$73.9 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 at both PEC and IBS, of an authorized \$125.0 million and \$50.0 million, respectively, to support business operations. These guarantees are not reflected on the Condensed 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; and (3) \$31.6 million supporting outstanding debt at Integrys Energy Services' subsidiaries. Parental guarantees

related to subsidiary debt and credit agreements outstanding are not included on the Condensed Consolidated Balance Sheets.

- (3) Comprised of \$282.9 million issued to support Integrys Energy Services' operations; \$4.3 million issued for workers compensation coverage in Illinois; and \$0.9 million related to letters of credit at UPPCO, MGU, and MERC. These amounts are not reflected on the Condensed Consolidated Balance Sheets.
- (4) 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.
- (5) Includes (1) a liability related to WPS's agreement to indemnify Dominion Energy Kewaunee, Inc. for certain costs arising from the resolution of design basis documentation issues incurred prior to the Kewaunee nuclear power plant's scheduled maintenance period in 2009. As of September 30, 2009, WPS had paid \$8.7 million to Dominion Energy Kewaunee, Inc. related to this guarantee, reducing the liability to \$0.2 million. WPS expects to make payments for the entire remaining liability amount by December 31, 2009; (2) a \$1.4 million indemnification provided by Integrys Energy Services related to the sale of Niagara. This indemnification, which terminates on January 31, 2010, 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; and (3) \$0.6 million issued for workers compensation coverage in Michigan.

Integrys Energy Group has provided total parental guarantees of \$1,792.8 million on behalf of Integrys Energy Services. Integrys Energy Group's exposure under these guarantees related to open transactions at September 30, 2009, was approximately \$604 million. At September 30, 2009, management was authorized to issue corporate guarantees up to an aggregate amount of \$2.65 billion to support the business operations of Integrys Energy Services. The following outstanding amounts were subject to this limit:

(Millions)	September 30, 2009	
Guarantees supporting commodity transactions	\$	1,476.8
Guarantees of subsidiary debt		31.6
Standby letters of credit		282.9
Surety bonds		1.5
Total guarantees subject to \$2.65 billion limit	\$	1,792.8

NOTE 15--EMPLOYEE BENEFIT PLANS

The following table shows the components of net periodic benefit cost for Integrys Energy Group's benefit plans.

(Millions)	Pension Benefits				Other Postretirement Benefits			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30 2009	September 30 2008	September 30 2009	September 30 2008	September 30 2009	September 30 2008	September 30 2009	September 30 2008
Service cost	\$ 9.7	\$ 9.6	\$ 29.1	\$ 28.8	\$ 3.6	\$ 4.0	\$ 10.7	\$ 11.8
Interest cost	20.2	19.1	60.7	57.2	6.6	6.5	19.9	19.3
Expected return on plan assets	(23.1)	(25.3)	(69.4)	(75.7)	(4.4)	(4.6)	(13.3)	(13.8)
Amortization of transition obligation	-	-	-	-	0.1	0.1	0.2	