

Columbia Plant:

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

WP&L, on behalf of itself and the joint owners, sent a Notice of Deficiency to the Sierra Club regarding the NOI. In response, the Sierra Club filed a Supplemental NOI on December 14, 2009, purporting to correct the deficiencies. The parties exchanged initial proposals regarding resolution. On September 9, 2010, the Sierra Club filed suit against WP&L in the Federal Court for the Western District of Wisconsin related to one project identified in the NOI for the Columbia plant. Integrys Energy Group is reviewing the allegations in the lawsuit but is currently unable to predict the impact on its condensed consolidated financial statements.

Edgewater Plant:

On December 11, 2009, WPS, along with its co-owners, received from the Sierra Club a copy of an NOI to file a civil lawsuit against the EPA based on the EPA's failure to take actions against the co-owners and operator of the Edgewater generation station based upon allegations of failure to comply with the CAA. Specifically, the allegations suggest that PSD permits that imposed BACT limits on emissions from the facilities should have been obtained for Edgewater. Edgewater is jointly owned by WP&L (Units 3, 4, and 5), Wisconsin Electric (Unit 5), and WPS (Unit 4) and operated by WP&L. The parties are in the process of analyzing the Sierra Club's actions. Integrys Energy Group is currently unable to predict the impact on its condensed consolidated financial statements.

On December 21, 2009, WPS, along with its co-owners, received from the Sierra Club an NOI to file a civil lawsuit based on allegations that major modifications were made at the Edgewater generation station without complying with the PSD and Title V Operating Permit requirements of the CAA. Specifically, the allegations suggest that PSD permits that imposed BACT limits on emissions from the facilities should have been obtained for Edgewater. The parties are in the process of analyzing the allegations and have had discussions with the Sierra Club. In September 2010, the Sierra Club filed suit against WP&L regarding Edgewater. Integrys Energy Group is currently unable to predict the impact on its condensed consolidated financial statements.

Columbia and Edgewater Plants:

On December 14, 2009, the EPA issued an NOV to WP&L relative to its Nelson Dewey Plant and to WP&L and the other joint owners of the Columbia and Edgewater generation stations alleging violations of New Source Review requirements of the CAA for certain projects undertaken at those plants. WP&L is the operator of these plants and, along with the joint owners, has met with the EPA and exchanged proposals related to a possible resolution. Integrys Energy Group is currently unable to predict the impact on its condensed consolidated financial statements.

EPA Settlements with Other Utilities:

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

If it were ultimately determined in the actions identified above that historic projects at WPS's Pulliam and Weston plants required either a state or federal CAA permit, WPS may, under the applicable statutes, be required, in order to resolve any such claim, to:

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

In addition, under the CAA, citizen groups may pursue a claim.

Weston Air Permits

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

On April 27, 2007, the Sierra Club filed a second petition requesting a contested case hearing regarding the March 28, 2007 permit language, which was granted by the WDNR. Both parties subsequently moved for summary judgment. In a decision issued on November 8, 2007, the administrative law judge granted WPS's motion for summary judgment in that proceeding, upholding the March 28, 2007 permit language. The Sierra Club filed petitions with the Dane County Circuit Court on April 27, 2007, and November 14, 2007, for judicial review of the Weston 4 air permit and the underlying proceedings before the administrative law judge. These two judicial review proceedings were consolidated by the court. On February 12, 2009, the court upheld the administrative law judge's final order, which affirmed the WDNR's actions. The Sierra Club appealed this decision. On May 13, 2010, the Wisconsin Court of Appeals issued a ruling affirming that the WDNR's decisions on BACT, sulfur dioxide, and nitrogen oxide were reasonable. One issue, visible emissions, was sent back to the WDNR for further proceedings. The WDNR and WPS filed a Motion for Clarification on the issue of further proceedings on the visibility issue. The Court of Appeals withdrew its May 13, 2010 decision, and on June 24, 2010, it reaffirmed its decision on all other matters but clarified the visibility issue and directed the WDNR to reopen the permit and establish specific visibility limits. In July 2010, the WDNR, WPS, and the Sierra Club filed Petitions for Review with the Wisconsin Supreme Court. WPS and the WDNR objected to the Sierra Club's Petition. To date, no action has been taken by the Supreme Court. Integrys Energy Group is currently unsure how the Supreme Court will respond.

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 impact, if any, of compliance with any changes to the Weston 4 air permit on its future costs.

In December 2008, an NOV was issued to WPS by the WDNR alleging various violations of the air permits for Weston 4, as well as Weston 1 and 2. The alleged violations include an exceedance of the carbon monoxide and volatile organic compound limits at Weston 4, exceedances of the hourly sulfur dioxide limit in ten three-hour periods during startup/shutdown and during one separate event at Weston 4, and two that address baghouse operation at Weston 1 and 2. On July 22, 2009, an NOV was issued to WPS by the WDNR alleging violations of the opacity limits during two six-minute periods (one each at Weston 2 and 4) and of the sulfur dioxide average limit during one three-hour period at Weston 4. An NOV was issued to WPS in September 2009 relating to one event involving baghouse operation at

Weston 1 and 2 that occurred in December 2008. A fourth NOV was issued on December 14, 2009, for a clerical error involving pages missing from a quarterly report. Corrective actions have been taken for the events in the four NOVs. An enforcement conference was held on January 7, 2009, for the December 2008 NOV and on August 26, 2009, for the July 2009 NOV. Discussions with the WDNR on the severity classification of the events continue. Management believes it is very likely that the WDNR will refer the NOVs to the state Justice Department for enforcement. Management does not believe that these matters will have a material adverse impact on the condensed consolidated financial statements of Integrys Energy Group.

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

Pulliam Air Permit

The renewal of the Title V air permit for the Pulliam generating station was issued by the WDNR on April 30, 2009. On June 28, 2010, the EPA issued an order granting the Sierra Club's petition to object to the Title V permit. The order directs the WDNR to respond to the comments raised by the Sierra Club in its Petition (filed June 25, 2009). Integrys Energy Group has been working with the WDNR to address the order.

On October 22, 2010, WPS received from the Sierra Club a copy of an NOI to file a civil lawsuit against the EPA based on what the Sierra Club alleges to be the EPA's unreasonable delay in performing its duties related to the grant or denial of the Pulliam Title V permit. Integrys Energy Group is reviewing all these allegations but is currently unable to predict the impact on its condensed consolidated financial statements.

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 directed the WDNR to resolve the EPA's objections within 90 days and "terminate, modify, or revoke and reissue" the Title V permit accordingly. On September 22, 2010, the WDNR issued a draft permit. The parties are evaluating all options, including a challenge to the permit.

On July 14, 2010, WPS, along with its co-owners, received from the Sierra Club a copy of an NOI to file a civil lawsuit against the EPA based on what the Sierra Club alleges to be the EPA's unreasonable delay in performing its duties related to the granting or denial of the Title V permit. Specifically, they allege that the EPA has failed to take actions against the WDNR for its failure to take action regarding the Title V permit as ordered by the EPA. Integrys Energy Group is reviewing all these allegations but is currently unable to predict the impact on its condensed consolidated financial statements.

Mercury and Interstate Air Quality Rules

Mercury

The State of Wisconsin's mercury rule, Chapter NR 446, requires a 40% reduction from the 2002 through 2004 baseline mercury emissions in Phase I, beginning January 1, 2010, through the end of 2014. In Phase II, which begins in 2015, electric generating units above 150 megawatts will be required to reduce

mercury emissions by 90%. Reductions can be phased in and the 90% target can be delayed until 2021 if additional sulfur dioxide and nitrogen oxide reductions are implemented. By 2015, electric generating units above 25 megawatts but less than 150 megawatts must reduce their mercury emissions to a level defined by the BACT rule. As of September 30, 2010, WPS estimates capital costs of approximately \$20 million for Phase I and Phase II, which includes estimates for both wholly owned and jointly owned plants, to achieve the required reductions. The capital costs are expected to be recovered in future rate cases. Because of the vacatur of the federal mercury control and monitoring rule in February 2008, the EPA is reviewing options for a new rulemaking to address hazardous air pollutants, including mercury, and is expected to issue a draft rule in 2011.

Sulfur Dioxide and Nitrogen Oxide

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

On July 11, 2008, the U.S. Court of Appeals issued a decision vacating CAIR, the EPA appealed, and in December 2008, the Court of Appeals reversed the CAIR vacatur and CAIR was reinstated. The Court of Appeals directed the EPA to address the deficiencies noted in its July 11, 2008 ruling, and the EPA issued a draft CAIR replacement rule for comment on July 6, 2010. As a result of the Court of Appeals' decision, CAIR is in place for 2010. WPS has not acquired any nitrogen oxide allowances for vintage years beyond 2010 other than those allocated by the EPA and does not expect any material impact as a result of the vacatur and subsequent reinstatement of CAIR. Integrys Energy Group will continue to evaluate the impacts of any subsequent rulemaking.

Due to the reinstatement of CAIR, units affected by the Best Available Retrofit Technology (BART) rule are considered in compliance with BART for sulfur dioxide and nitrogen oxide emissions. Although particulate emissions also contribute to visibility impairment, the WDNR's modeling has shown the impairment to be so insignificant that additional capital expenditures on controls are not warranted.

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 \$453 million, which includes estimates for both wholly owned and WPS's share of jointly owned plants, in order to meet an assumed 2015 compliance date. This estimate is based on costs of current control technology and current information regarding the final state and federal rules. The capital costs are anticipated to be recovered in future rate cases.

Manufactured Gas Plant Remediation

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

Integrys Energy Group's natural gas utilities are responsible for the environmental impacts at 55 manufactured gas plant sites located in Wisconsin, Michigan, and Illinois. All are former regulated utility sites and are being remediated, with costs charged to existing ratepayers at WPS, MGU, PGL, and NSG. Twenty of these sites have been transferred to the EPA Superfund Alternative Sites Program. Under the

EPA's program, the remedy decisions at these sites will be based on risk-based criteria typically used at Superfund sites. Integrys Energy Group estimated and accrued for \$650.4 million of future undiscounted investigation and cleanup costs for all sites as of September 30, 2010. Integrys Energy Group may adjust these estimates in the future, contingent upon remedial technology, regulatory requirements, remedy determinations, and any claims of natural resource damages. Integrys Energy Group recorded a regulatory asset of \$663.5 million, which is net of insurance recoveries received of \$56.9 million, related to the expected recovery of both deferred expenditures and estimated future expenditures as of September 30, 2010.

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

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

Management believes that any costs incurred for environmental activities relating to former manufactured gas plant operations that are not recoverable through contributions from other entities or from insurance carriers have been prudently incurred and are, therefore, recoverable through rates for WPS, MGU, PGL, and NSG. Accordingly, management believes that the costs incurred in connection with former manufactured gas plant operations will not have a material adverse effect on the condensed consolidated financial statements of Integrys Energy Group.

Greenhouse Gases

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

The EPA will begin regulating greenhouse gas emissions under the Clean Air Act in 2011, unless there is a successful legal challenge that stays the rule (several lawsuits have been filed). At that time, the EPA and the states will apply the BACT requirements associated with the new source review program to new and modified larger greenhouse gas emitters. Technology to remove and sequester greenhouse gas emissions is not commercially available at scale; hence, the EPA is considering defining BACT in terms of improvements in energy efficiency as opposed to relying on pollution control equipment. In addition, federal legislation related to greenhouse gas emissions may be enacted in the future, and efforts have been initiated to develop state and regional greenhouse gas programs, to create federal legislation to limit carbon dioxide emissions, and to create national or state renewable portfolio standards. 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.

Natural Gas Charge Reconciliation Proceedings and Related Matters

Natural Gas Charge Settlement and Pending Natural Gas Charge Cases

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

In March 28, 2006 orders, the ICC adopted a settlement agreement related to fiscal years 2001 through 2004 natural gas costs. Under the settlement agreement, PEC agreed to provide the Illinois Attorney General (AG) and the City of Chicago (Chicago) up to \$30.0 million for conservation and weatherization programs for which PGL and NSG may not seek rate recovery. The balance of the conservation and weatherization funding that remained unpaid as of September 30, 2010, was \$5.2 million and was recorded in other current liabilities. PEC also agreed to implement a reconnection program for certain customers, and PGL and NSG implemented this program. Finally, PEC agreed to internal audits and an external audit of natural gas supply practices. Four of the five annual internal audits required by the settlement agreement have been completed. The external audit was completed in April 2008, and PGL and NSG completed their responses to the external auditor's recommendations in March 2009.

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. The Administrative Law Judge's proposed order rejected the interveners' proposal. Briefing on the proposed order concluded on June 4, 2010. For NSG, there were no contested issues, and the ICC issued an order on May 25, 2010.

Reconciliations of subsequent periods (2007 - 2009 for NSG and 2006 - 2009 for PGL) were held in abeyance pending the outcome of the fiscal 2006 Gas Charge reconciliation cases, but ICC Staff and an intervener filed testimony for the 2007 Gas Charge reconciliation period on October 22, 2010. They recommended no disallowances although the intervener recommended a change in how certain pipeline costs are recovered. There has been no ICC Staff or intervener testimony for the 2008 and 2009 reconciliation periods, and NSG and PGL are not aware of any issues for those periods.

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. On November 19, 2009, the court entered an order certifying a class composed of customers of PGL and NSG during the period April 26, 2000, through September 30, 2002. The case remained pending in Circuit court. The parties entered into a settlement agreement on September 23, 2010, that was preliminarily approved by the court on September 27, 2010. The hearing for final approval is scheduled for November 30, 2010. At September 30, 2010, Integrys Energy Group had an \$8.8 million liability recorded related to the settlement agreement.

NOTE 15--GUARANTEES

The following table shows outstanding guarantees at Integrys Energy Group:

<i>(Millions)</i>	Total Amounts Committed at September 30, 2010	Expiration			
		Less Than 1 Year	1 to 3 Years	4 to 5 Years	Over 5 Years
Guarantees supporting commodity transactions of subsidiaries ⁽¹⁾	\$716.1	\$437.4	\$46.2	\$ -	\$232.5
Standby letters of credit ⁽²⁾	107.4	89.7	17.6	0.1	-
Surety bonds ⁽³⁾	3.2	2.1	1.1	-	-
Other guarantees ⁽⁴⁾	73.5	-	-	50.0	23.5
Total guarantees	\$900.2	\$529.2	\$64.9	\$50.1	\$256.0

- (1) Consists of parental guarantees of \$517.5 million to support the business operations of Integrys Energy Services; \$123.2 million and \$65.4 million, respectively, related to natural gas supply at MERC and MGU; and \$5.0 million at both PEC and IBS to support business operations. These guarantees are not reflected on the Condensed Consolidated Balance Sheets.
- (2) At Integrys Energy Group's request, financial institutions have issued standby letters of credit for the benefit of third parties that have extended credit to Integrys Energy Group. This amount consists of \$95.2 million issued to support Integrys Energy Services' operations; \$10.4 million issued for workers compensation coverage in Illinois; and \$1.8 million related to letters of credit issued to support UPPCO, WPS, MGU, NSG, MERC, and PGL operations. These amounts are not reflected on the Condensed Consolidated Balance Sheets.
- (3) Primarily for workers compensation coverage and obtaining various licenses, permits, and rights of way. Surety bonds are not included on the Condensed Consolidated Balance Sheets.
- (4) Consists of (1) \$50.0 million related to the sale agreement for Integrys Energy Services' United States wholesale electric marketing and trading business, which included a number of customary representations, warranties, and indemnification provisions. In addition, for a two-year period, counterparty payment default risk was retained with approximately 50% of the counterparties associated with the commodity contracts transferred in this transaction. An insignificant liability was recorded related to the fair value of this counterparty payment default risk; (2) \$10.0 million related to the sale agreement for Integrys Energy Services' Texas retail marketing business, which included a number of customary representations, warranties, and indemnification provisions. An insignificant liability was recorded related to the possible imposition of additional miscellaneous gross receipts tax in the event of a change in law or interpretation of the tax law; (3) \$5.0 million related to an environmental indemnification provided by Integrys Energy Services as part of the sale of the Stoneman generation facility, under which Integrys Energy Group expects that the likelihood of required performance is remote. This amount is not reflected on the Condensed Consolidated Balance Sheets; and (4) \$8.5 million related to other indemnifications and workers compensation coverage. This amount is not reflected on the Condensed Consolidated Balance Sheets.

Integrys Energy Group has provided total parental guarantees of \$707.1 million on behalf of Integrys Energy Services, as shown in the table below. Integrys Energy Group's exposure under these guarantees related to open transactions at September 30, 2010, was approximately \$455 million based on (1) an assumption that 60 days of payables are outstanding, and (2) the valuation of forward contracts.

<i>(Millions)</i>	September 30, 2010
Guarantees supporting commodity transactions	\$517.5
Standby letters of credit	95.2
Guarantees of subsidiary debt *	27.0
Surety bonds	1.7
Other	65.7
Total guarantees	\$707.1

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

NOTE 16--EMPLOYEE BENEFIT PLANS

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

<i>(Millions)</i>	Pension Benefits				Other Postretirement Benefits			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30 2010	2009	September 30 2010	2009	September 30 2010	2009	September 30 2010	2009
Service cost	\$10.0	\$ 9.7	\$30.1	\$29.1	\$4.1	\$3.6	\$12.3	\$10.7
Interest cost	20.0	20.2	60.0	60.7	6.9	6.6	20.6	19.9
Expected return on plan assets	(23.1)	(23.1)	(69.2)	(69.4)	(4.7)	(4.4)	(14.2)	(13.3)
Amortization of transition obligation	-	-	-	-	0.1	0.1	0.2	0.2
Amortization of prior service cost (credit)	1.3	1.3	3.9	3.8	(1.0)	(1.0)	(2.9)	(2.9)
Amortization of net actuarial loss (gain)	2.0	0.5	6.1	1.4	0.5	(0.4)	1.4	(1.1)
Amortization of merger related regulatory adjustment ⁽¹⁾	-	3.1	-	9.4	-	0.8	-	2.5
Regulatory deferral ⁽²⁾	1.2	(0.8)	3.4	(2.4)	(0.4)	(0.4)	(1.0)	(1.2)
Net periodic benefit cost	\$11.4	\$10.9	\$34.3	\$32.6	\$5.5	\$4.9	\$16.4	\$14.8

(1) Effective with the 2010 rate order, PGL and NSG reflect pension and other postretirement benefit costs in rates using Integrys Energy Group's accounting basis, which was established at the time of the February 2007 PEC merger. As a result, the merger related regulatory adjustment was eliminated. Pursuant to the 2010 rate order, a new regulatory asset was established for the remaining cumulative difference that existed between the accounting bases of PGL/NSG and Integrys Energy Group in the pension and other postretirement benefit obligations. The amortization of this regulatory asset over the average remaining service lives of the participating employees is not included as a component of net periodic benefit cost.

(2) The PSCW authorized WPS to recover its net increased 2009 pension costs and to refund its net decreased 2009 other postretirement benefit costs as part of the limited rate case re-opener for 2010. Amortization and recovery/refund of these costs will be completed by December 31, 2010.

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

Contributions to the plans are made in accordance with legal and tax requirements and do not necessarily occur evenly throughout the year. For the nine months ended September 30, 2010, \$64.3 million of contributions were made to the pension plans, and contributions made to the other postretirement benefit plans were not significant. Integrys Energy Group expects to contribute an additional \$101.4 million to its pension plans and \$35.2 million to its other postretirement benefit plans during the remainder of 2010.

NOTE 17--STOCK-BASED COMPENSATION

In May 2010, Integrys Energy Group's shareholders approved the 2010 Omnibus Incentive Compensation Plan (2010 Omnibus Plan). Under the provisions of the 2010 Omnibus Plan, the number of shares of stock that may be issued in satisfaction of plan awards may not exceed 3,000,000, and no more than 900,000 shares of stock can be granted as performance shares or restricted stock. No additional awards will be issued under prior plans, although the plans continue to exist for purposes of the existing outstanding stock-based compensation. At September 30, 2010, stock options, performance stock rights, restricted shares and restricted share units, and stock appreciation rights were outstanding under the various plans.

Performance stock rights, restricted shares, and restricted share units were accounted for as equity awards through June 30, 2010; however, in the third quarter of 2010, Integrys Energy Group determined that these awards should have been accounted for as liability awards due to certain changes to the deferred compensation plan approved by Integrys Energy Group's Board of Directors in the fourth quarter of 2007. In the third quarter of 2010, consistent with the guidance in the Stock Compensation Topic of the FASB ASC, Integrys Energy Group began accounting for performance stock rights, restricted shares, and restricted share units as liability awards, which are required to be recorded at fair value each reporting period. The cumulative effect of this change related to periods prior to the third quarter of 2010 was a decrease in net income from continuing operations and net income attributed to common shareholders of \$2.4 million. Management determined that this amount was not material to prior periods or to the quarter ended September 30, 2010, and recorded the cumulative effect in earnings in the third quarter of 2010.

Stock Options

Compensation cost recognized for stock options during the three and nine months ended September 30, 2010, and 2009, was not significant. As of September 30, 2010, \$1.9 million of compensation cost related to unvested and outstanding stock options was expected to be recognized over a weighted-average period of 2.8 years.

Cash received from option exercises during the nine months ended September 30, 2010, was \$17.6 million. The tax benefit realized from these option exercises was \$7.1 million.

A summary of stock option activity for the nine months ended September 30, 2010, and information related to outstanding and exercisable stock options at September 30, 2010, is presented below:

	Stock Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value (Millions)
Outstanding at December 31, 2009	3,133,286	\$47.06		
Granted	554,092	41.58		
Exercised	461,414	47.81		\$ 6.4
Forfeited	149,875	43.03		1.4
Expired	56,649	49.68		0.2
Outstanding at September 30, 2010	3,019,440	\$47.58	6.51	\$15.8
Exercisable at September 30, 2010	1,796,846	\$49.56	5.29	\$ 5.9

The aggregate intrinsic value for outstanding and exercisable options in the above table represents the total pre-tax value that would have been received by the option holders had they all exercised their

options at September 30, 2010. This is calculated as the difference between Integrys Energy Group's closing stock price on September 30, 2010, and the option exercise price, multiplied by the number of in-the-money stock options.

Performance Stock Rights

Compensation cost recognized for performance stock rights during the three months ended September 30, 2010, was \$6.0 million and was not significant during the three months ended September 30, 2009. Compensation cost recorded for performance stock rights during the nine months ended September 30, 2010, and 2009, was \$8.5 million and \$3.2 million, respectively. As of September 30, 2010, \$6.7 million of compensation cost related to unvested and outstanding performance stock rights was expected to be recognized over a weighted-average period of 1.4 years.

A summary of the activity related to performance stock rights for the nine months ended September 30, 2010, is presented below:

	Performance Stock Rights
Outstanding at December 31, 2009	301,090
Granted	150,481
Distributed	45,847
Forfeited	26,009
Expired	37,849
Outstanding at September 30, 2010	341,866

Restricted Shares and Restricted Share Units

Compensation cost recognized for restricted share and restricted share unit awards during the three months ended September 30, 2010, was \$5.6 million and was not significant during the three months ended September 30, 2009. Compensation cost recognized for these awards during the nine months ended September 30, 2010, and 2009, was \$8.4 million and \$3.7 million, respectively. As of September 30, 2010, \$14.7 million of compensation cost related to these awards was expected to be recognized over a weighted-average period of 2.7 years.

A summary of the activity related to restricted share and restricted share unit awards for the nine months ended September 30, 2010, is presented below:

	Restricted Share and Restricted Share Unit Awards
Outstanding at December 31, 2009	346,858
Granted	210,452
Vested	93,994
Forfeited	45,924
Outstanding at September 30, 2010	417,392

NOTE 18--COMPREHENSIVE INCOME (LOSS)

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

<i>(Millions)</i>	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
Net income (loss) attributed to common shareholders	\$ 20.2	\$51.1	\$148.6	\$(94.4)
Cash flow hedges, net of tax *	(29.1)	22.4	(21.4)	17.0
Foreign currency translation, net of tax	(2.5)	1.9	(2.4)	3.2
Amortization of unrecognized pension and other postretirement benefit costs, net of tax	0.1	0.1	0.6	(0.1)
Unrealized loss on available-for-sale securities, net of tax	-	-	-	0.1
Total comprehensive income (loss)	\$(11.3)	\$75.5	\$125.4	\$(74.2)

* For the three months ended September 30, 2010, the tax benefit was \$18.6 million, and for the three months ended September 30, 2009, the tax was \$14.3 million. For the nine months ended September 30, 2010, the tax benefit was \$11.3 million, and for the nine months ended September 30, 2009, the tax was \$9.7 million.

The following table shows the changes to Integrys Energy Group's accumulated other comprehensive loss from December 31, 2009, to September 30, 2010.

<i>(Millions)</i>	Nine Months Ended September 30, 2010
December 31, 2009 balance	\$(44.0)
Cash flow hedges	(21.4)
Foreign currency translation	(2.4)
Amortization of unrecognized pension and other postretirement benefit costs	0.6
September 30, 2010 balance	\$(67.2)

NOTE 19--COMMON EQUITY

Integrys Energy Group's reconciliation of shares outstanding was as follows:

	September 30, 2010		December 31, 2009	
	Shares	Average Cost	Shares	Average Cost
Common stock issued	77,486,900		76,418,843	
Less:				
Deferred compensation rabbi trust	384,484	\$42.83 ⁽¹⁾	402,839	\$42.58 ⁽¹⁾
Restricted stock	16,873	\$54.80 ⁽²⁾	35,861	\$55.33 ⁽²⁾
Total shares outstanding	77,085,543		75,980,143	

⁽¹⁾ Based on Integrys Energy Group's stock price on the day the shares entered the deferred compensation rabbi trust. Shares paid out of the trust are valued at the average cost of shares in the trust.

⁽²⁾ Based on the grant date fair value of the restricted stock.

Beginning February 11, 2010, Integrys Energy Group issued new shares of common stock to meet the requirements of its Stock Investment Plan and certain stock-based employee benefit and compensation plans. From January 1, 2010 to February 10, 2010, and during 2009, Integrys Energy Group purchased shares of its common stock on the open market to meet the requirements of these plans.

Integrys Energy Group had the following changes to issued common stock during the nine months ended September 30, 2010:

Integrys Energy Group's common shares	
Common stock at December 31, 2009	76,418,843
Shares issued	
Stock Investment Plan	561,483
Stock-based compensation	519,610
Restricted stock shares retired	(13,036)
Common stock at September 30, 2010	77,486,900

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) attributed to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) attributed to common shareholders by the weighted average number of common shares outstanding during the period, adjusted for the exercise and/or conversion of all potentially dilutive securities. Such dilutive items include in-the-money stock options, performance stock rights, and restricted stock. The calculation of diluted earnings per share for the three months ended September 30, 2010, and 2009, excluded 0.8 million and 3.0 million, respectively, out-of-the-money stock options that had an anti-dilutive effect. The calculation of diluted earnings per share for the nine months ended September 30, 2010, excluded 1.6 million out-of-the-money stock options that had an anti-dilutive effect. The calculation of diluted earnings per share for the nine months ended September 30, 2009, excluded 3.1 million out-of-the-money stock options. Also, the effects of an insignificant number of in-the-money securities were not included in the computation for the nine months ended September 30, 2009, because there was a net loss, which would have caused the impact to be anti-dilutive. The following table reconciles the computation of basic and diluted earnings (loss) per share:

<i>(Millions, except per share amounts)</i>	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
<u>Numerator:</u>				
Net income (loss) from continuing operations	\$20.9	\$49.1	\$150.5	\$(95.4)
Discontinued operations, net of tax	-	2.3	0.1	2.6
Preferred stock dividends of subsidiary	(0.7)	(0.7)	(2.3)	(2.3)
Noncontrolling interest in subsidiaries	-	0.4	0.3	0.7
Net income (loss) attributed to common shareholders	\$20.2	\$51.1	\$148.6	\$(94.4)
<u>Denominator:</u>				
Average shares of common stock – basic	77.7	76.8	77.3	76.8
Effect of dilutive securities				
Stock-based compensation	0.4	0.1	0.5	-
Average shares of common stock – diluted	78.1	76.9	77.8	76.8
Earnings (loss) per common share				
Basic	\$0.26	\$0.67	\$1.92	\$(1.23)
Diluted	0.26	0.66	1.91	(1.23)

NOTE 20--VARIABLE INTEREST ENTITIES

Effective January 1, 2010, Integrys Energy Group implemented SFAS No. 167, "Amendments to FASB Interpretation No. 46 (R)" (now incorporated as part of the Consolidation Topic of the FASB ASC). Integrys Energy Group has variable interests in two entities through power purchase agreements relating to the cost of fuel. One of these purchased power agreements reimburses an independent power producing entity for coal costs relating to purchased energy. There is no obligation to purchase energy under the agreement. This contract expires in 2016. The other agreement contains a tolling arrangement in which Integrys Energy Group supplies the scheduled fuel and purchases capacity and energy from the facility. This contract also expires in 2016. As of September 30, 2010 and December 31, 2009, Integrys Energy Group had approximately 535 megawatts of capacity available under these agreements.

Integrys Energy Group has evaluated each of these variable interest entities for possible consolidation. In these cases, Integrys Energy Group considered which interest holder has the power to direct the activities that most significantly impact the economics of the variable interest entity; this interest holder is considered the primary beneficiary of the entity and is required to consolidate the entity. For a variety of reasons, including qualitative factors such as the length of the remaining term of the contracts compared with the remaining lives of the plants and the fact that Integrys Energy Group does not have the power to direct the operations and maintenance of the facilities. Integrys Energy Group determined it is not the primary beneficiary of these variable interest entities.

At September 30, 2010, the assets and liabilities on the Condensed Consolidated Balance Sheets that related to the involvement with these variable interest entities pertained to working capital accounts and represented the amounts owed by Integrys Energy Group for current deliveries of power. Integrys Energy Group has not provided or guaranteed any debt or equity support, liquidity arrangements, performance guarantees, or other commitments associated with these contracts. There is no significant potential exposure to loss as a result of its involvement with the variable interest entities.

In 2008, Integrys Energy Group's subsidiary, Integrys Energy Services, contributed certain assets to LGS Renewables I, L.C. (LGS) in exchange for a 50% interest in the entity. Simultaneously, Integrys Energy Services entered into a loan agreement with LGS to finance the development and construction of a pipeline project to provide landfill gas to a customer. Integrys Energy Group determined at the time that the entity was a variable interest entity and that Integrys Energy Services was the primary beneficiary of the entity. Integrys Energy Group updated its conclusion upon implementation of the new standard and continued to conclude that Integrys Energy Services was the primary beneficiary. In July 2010, Integrys Energy Services purchased LGS Development, L.P.'s 50% ownership interest in LGS and became the sole owner.

NOTE 21--FAIR VALUE

Fair Value Measurements

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

The following tables show Integrys Energy Group's assets and liabilities that were accounted for at fair value on a recurring basis, categorized by level within the fair value hierarchy.

September 30, 2010				
(Millions)	Level 1	Level 2	Level 3	Total
Assets				
Risk Management Assets				
Utility Segments				
Financial transmission rights	\$ -	\$ -	\$ 5.6	\$ 5.6
Natural gas contracts	0.6	0.7	-	1.3
Petroleum product contracts	0.3	-	-	0.3
Nonregulated Segments				
Natural gas contracts	75.0	135.5	51.0	261.5
Electric contracts	32.9	125.3	21.6	179.8
Interest rate swaps	-	0.9	-	0.9
Foreign exchange contracts	0.1	1.2	-	1.3
Total Risk Management Assets	\$108.9	\$263.6	\$78.2	\$450.7
Other Assets	\$ 0.1	\$ -	\$ -	\$ 0.1
Liabilities				
Risk Management Liabilities				
Utility Segments				
Financial transmission rights	\$ -	\$ -	\$ 0.6	\$ 0.6
Natural gas contracts	6.4	36.7	-	43.1
Nonregulated Segments				
Natural gas contracts	82.4	154.3	5.5	242.2
Electric contracts	61.9	179.6	58.4	299.9
Interest rate swaps	-	9.4	-	9.4
Foreign exchange contracts	1.2	0.1	-	1.3
Total Risk Management Liabilities	\$151.9	\$380.1	\$ 64.5	\$596.5
Long-term debt hedged by fair value hedge	\$ -	\$ 50.9	\$ -	\$ 50.9

December 31, 2009				
(Millions)	Level 1	Level 2	Level 3	Total
Assets				
Risk management assets	\$284.9	\$439.6	\$1,593.0	\$2,317.5
Other	0.1	-	-	0.1
Liabilities				
Risk management liabilities	336.4	582.2	1,471.6	2,390.2
Long-term debt hedged by fair value hedge	-	52.6	-	52.6

Integrys Energy Group determined the fair values above using a market based approach that incorporated observable market inputs where available, and internally developed inputs where observable market data was not readily available. For the unobservable inputs, consideration was given to the assumptions that market participants would use in valuing the asset or liability. These factors include not only the credit standing of the counterparties involved, but also the impact of Integrys Energy Group's nonperformance risk on its liabilities.

The risk management assets and liabilities listed in the tables include options, swaps, futures, physical commodity contracts, and other instruments used to manage market risks related to changes in commodity prices and interest rates. For more information on Integrys Energy Group's derivative instruments, see Note 3, "Risk Management Activities."

When possible, Integrys Energy Group bases the valuations of its risk management assets and liabilities on quoted prices for identical assets in active markets. These valuations are classified in Level 1. The valuations of certain contracts include inputs related to market price risk (commodity or interest rate), price volatility (for option contracts), price correlation (for cross commodity contracts), credit risk, and time

value. These inputs are available through multiple sources, including brokers and over-the-counter and online exchanges. Transactions valued using these inputs are classified in Level 2.

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

- While price curves may have been based on observable information, significant assumptions may have been made regarding seasonal or monthly shaping and locational basis differentials.
- Certain transactions were valued using price curves that extended beyond the quoted period. Assumptions were made to extrapolate prices from the last quoted period through the end of the transaction term, primarily through use of historically settled data or using correlations to other locations.

Integrus Energy Group recognizes transfers between the levels of the fair value hierarchy at the value as of the end of the reporting period.

The following tables show net risk management assets (liabilities) transferred between the levels of the fair value hierarchy during the three and nine months ended September 30, 2010.

Nonregulated Segments – Electric Contracts						
<i>(Millions)</i>	Three Months Ended September 30, 2010			Nine Months Ended September 30, 2010		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Transfers into Level 1 from	N/A	\$(0.3)	\$(0.6)	N/A	\$(10.1)	\$(18.0)
Transfers into Level 2 from	\$(0.2)	N/A	(4.0)	\$(0.2)	N/A	2.8
Transfers into Level 3 from	-	-	N/A	-	(4.8)	N/A

Nonregulated Segments – Natural Gas Contracts						
<i>(Millions)</i>	Three Months Ended September 30, 2010			Nine Months Ended September 30, 2010		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Transfers into Level 1 from	N/A	\$ -	\$ -	N/A	\$ -	\$ -
Transfers into Level 2 from	\$ -	N/A	0.8	\$ -	N/A	0.8
Transfers into Level 3 from	-	-	N/A	-	-	N/A

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

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

Three Months Ended September 30, 2010	Nonregulated Segments		Utility Segments	
	Natural Gas	Electric	Financial Transmission Rights	Total
<i>(Millions)</i>				
Balance at the beginning of the period	\$33.0	\$(36.1)	\$7.6	\$ 4.5
Net realized and unrealized gains (losses) included in earnings	20.3	(12.8)	1.0	8.5
Net unrealized losses recorded as regulatory assets or liabilities	-	-	(1.8)	(1.8)
Net unrealized losses included in other comprehensive loss	-	(3.3)	-	(3.3)
Net purchases and settlements	(7.0)	10.8	(1.8)	2.0
Net transfers out of Level 3	(0.8)	4.6	-	3.8
Balance at the end of the period	\$45.5	\$(36.8)	\$5.0	\$13.7
Net unrealized gains (losses) included in earnings related to instruments still held at the end of the period	\$20.3	\$(12.8)	\$ -	\$ 7.5

<u>Nine Months Ended September 30, 2010</u> (Millions)	<u>Nonregulated Segments</u>		<u>Utility Segments</u>	<u>Total</u>
	<u>Natural Gas</u>	<u>Electric</u>	<u>Financial Transmission Rights</u>	
Balance at the beginning of the period	\$31.4	\$ 86.5	\$3.5	\$121.4
Net realized and unrealized gains (losses) included in earnings	42.7	(71.7)	4.5	(24.5)
Net unrealized gains recorded as regulatory assets or liabilities	-	-	0.3	0.3
Net unrealized losses included in other comprehensive loss	-	(6.5)	-	(6.5)
Net purchases and settlements	(27.8)	(55.5)	(3.3)	(86.6)
Net transfers into Level 3	-	(4.8)	-	(4.8)
Net transfers out of Level 3	(0.8)	15.2	-	14.4
Balance at the end of the period	\$45.5	\$(36.8)	\$5.0	\$ 13.7
Net unrealized gains (losses) included in earnings related to instruments still held at the end of the period	\$42.7	\$(71.7)	\$ -	\$ (29.0)

<u>(Millions)</u>	<u>Three Months Ended September 30, 2009</u>	<u>Nine Months Ended September 30, 2009</u>
	Balance at the beginning of the period	\$ (42.6)
Net realized and unrealized losses included in earnings	27.7	(12.8)
Net unrealized gains recorded as regulatory assets or liabilities	(1.8)	4.1
Net unrealized gains (losses) included in other comprehensive loss	13.8	5.1
Net purchases and settlements	(21.6)	(8.6)
Net transfers in/out of Level 3	120.0	(74.3)
Balance at the end of the period	\$ 95.5	\$ 95.5
Net unrealized losses included in earnings related to instruments still held at the end of the period	\$ 27.8	\$ (10.1)

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

Fair Value of Financial Instruments

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

<u>(Millions)</u>	<u>September 30, 2010</u>		<u>December 31, 2009</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Long-term debt	\$2,390.6	\$2,552.0	\$2,511.2	\$2,543.6
Preferred stock	51.1	49.6	51.1	44.3

The fair values of long-term debt instruments are estimated based on the quoted market price for the same or similar issues, or on the current rates offered to Integrys Energy Group for debt of the same remaining maturity, without considering the effect of third-party credit enhancements. The fair values of preferred stock are estimated based on quoted market prices when available, or by using a perpetual dividend discount model.

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

NOTE 22--MISCELLANEOUS INCOME

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

<i>(Millions)</i>	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
Equity earnings on investments	\$19.3	\$19.5	\$58.8	\$56.6
Foreign currency translation gain reclassified from OCI *	3.9	1.4	4.4	0.8
Key executive life insurance	0.9	1.1	2.9	2.3
Interest and dividend income	0.8	1.5	2.9	4.1
Equity portion of AFUDC	0.3	1.7	1.2	4.5
Other	1.1	0.3	0.9	(1.1)
Total miscellaneous income	\$26.3	\$25.5	\$71.1	\$67.2

* The foreign currency translation gains that had accumulated in OCI were reclassified from OCI and reported in other income in the period when Integrys Energy Services had substantially completed the liquidation of its Canadian subsidiaries. At September 30, 2010, no amounts remained in accumulated OCI related to foreign currency translation.

NOTE 23--REGULATORY ENVIRONMENT

Wisconsin

2011 Rate Case

On April 1, 2010, WPS filed an application with the PSCW to increase retail electric and natural gas rates \$64.2 million (6.9%) and \$5.0 million (1.2%), respectively, with rates effective January 1, 2011. The filing includes a request for an 11.25% return on common equity and a common equity ratio of 53.62% in WPS's regulatory capital structure. The proposed retail electric and natural gas rate increases for 2011 are being driven by decreased sales due primarily to the ongoing economic recession and increased energy efficiency efforts by customers, the amortization in 2011 of the 2009 deferred amounts under WPS's electric Revenue Stabilization Mechanism, and increased payments to the Wisconsin Focus on Energy program. The PSCW staff has recommended a retail electric rate increase of \$23.7 million and a retail natural gas rate decrease of \$8.0 million, including uncontested adjustments to the staff audit. A driver for the reduction from WPS's requested retail electric rate increase is that natural gas prices have fallen from the level when the initial filing was made, which impacted projected purchased power costs. A final order is expected in the fourth quarter of 2010.

2010 Rates

On December 22, 2009, the PSCW issued a final written order for WPS authorizing an electric rate increase of \$18.2 million, offset by an \$18.2 million refund of 2009 and 2008 fuel cost over-collections, and a retail natural gas rate increase of \$13.5 million, effective January 1, 2010. Based on an order issued on April 1, 2010, the remaining \$10.0 million of the total 2008 and 2009 fuel cost over-collections, plus interest of \$1.3 million, were refunded to customers in April and May 2010.

The PSCW issued another rate order on April 1, 2010, making fuel cost over-collections for 2010 subject to refund as of that date. As of September 30, 2010, the balance of the 2010 fuel cost over-collections to be refunded to customers in 2011 was \$9.4 million, which was recorded as a short-term regulatory liability. Fuel cost over/under-recovery impacts for 2008, 2009, and 2010 related to the Weston 4 power plant exfoliation issue remain open and will be addressed as part of the current 2011 rate case.

2009 Rates

On December 30, 2008, the PSCW issued a final written order for WPS authorizing no change in retail electric rates from the fuel surcharge adjusted rates authorized effective July 4, 2008, and a \$3.0 million decrease in retail natural gas rates. The PSCW also approved a decoupling mechanism as a four-year pilot program. The mechanism allows WPS to defer and recover or refund in future rate proceedings all or a portion of the differences between the actual and authorized margin per customer impact of variations in volumes. The annual deferral or refund is limited to \$14.0 million for electric service and \$8.0 million for natural gas service. The mechanism does not adjust for changes in volume resulting from changes in customer count and also does not cover large commercial and industrial customers.

Michigan

2011 UPPCO Rate Case

On June 30, 2010, UPPCO filed an application with the MPSC to increase retail electric rates \$15.4 million (16.8%), with rates effective January 1, 2011. The filing includes a request for an 11.25% return on common equity and a common equity ratio of 54.86% in UPPCO's regulatory capital structure. The proposed retail electric rate increase for 2011 is primarily being driven by increased capital investments associated with FERC-required replacements and upgrades of hydroelectric facilities, reduced wholesale and retail sales, and increased meter reading costs.

2010 UPPCO Rates

On December 16, 2009, the MPSC issued a final written order authorizing UPPCO a retail electric rate increase of \$6.5 million, effective January 1, 2010. The new rates reflect a 10.90% return on common equity and a common equity ratio of 54.83% in UPPCO's regulatory capital structure. The order included approval of a decoupling mechanism, as well as an uncollectibles expense tracking mechanism, which allows for the deferral and subsequent recovery or refund of 80% of the difference between actual write-offs (net of recoveries) and bad debt expense included in utility rates, both effective January 1, 2010.

2010 MGU Rates

On December 16, 2009, the MPSC issued a final written order authorizing MGU a retail natural gas rate increase of \$3.5 million, effective January 1, 2010. The filing included a 10.75% return on common equity and a common equity ratio of 50.26% in MGU's regulatory capital structure. The order included approval of an uncollectibles expense tracking mechanism, which allows for the deferral and subsequent recovery or refund of 80% of the difference between actual write-offs (net of recoveries) and bad debt expense included in utility rates, effective January 1, 2010. On July 1, 2010, the MPSC granted an order approving a decoupling mechanism for MGU as a pilot program, effective September 1, 2010. MGU's approved decoupling mechanism adjusts for the impact on revenues of changes in weather-normalized use per customer for residential and small commercial customers. On July 29, 2010, MGU filed with the MPSC a petition for rehearing requesting, among other items, an effective date for decoupling of January 1, 2010, consistent with the effective date of final rates under the MPSC's December 16, 2009 order. On October 26, 2010, the MPSC granted MGU's rehearing petition and ordered decoupling to be effective January 1, 2010.

2009 MGU Rates

On January 13, 2009, the MPSC issued a final written order for MGU approving a settlement agreement authorizing an annual retail natural gas rate increase of \$6.0 million, effective January 14, 2009. The new rates reflected a 10.45% return on common equity and a common equity ratio of 50.01% in MGU's regulatory capital structure.

Illinois

2010 Rates

On January 21, 2010, the ICC issued a final order authorizing a retail natural gas rate increase of \$69.8 million for PGL and \$13.9 million for NSG, effective January 28, 2010. The rates for PGL reflect a 10.23% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The rates for NSG reflect a 10.33% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The ICC approved a rider mechanism to recover the costs, above an annual baseline, of an accelerated natural gas main replacement program by PGL through a special charge on customers' bills, known as Rider ICR. The rate order also approved the recovery of net dismantling costs of property, plant, and equipment over the life of the asset rather than when incurred. PGL and NSG, as well as Chicago, the Attorney General (AG), and the Citizens Utility Board, filed requests for rehearing in February 2010, all addressing Rider ICR. On March 10, 2010, the ICC voted to grant rehearing on the Rider ICR annual baseline determination and denied all other rehearing requests, including requests about other aspects of Rider ICR. On rehearing, PGL proposed a baseline of \$45.28 million with an annual escalation factor. No party filed testimony opposing the proposal. On June 2, 2010, the ICC issued its rehearing order approving PGL's proposed baseline. Recovery of costs for the accelerated gas main replacement program will begin in 2011 with the first Rider ICR charges being effective April 1, 2011. The AG, the Citizens Utility Board, PGL, and NSG filed appeals with the Illinois Appellate Court, First District. On June 17, 2010, the AG filed a motion with the ICC to stay the effectiveness of Rider ICR or, alternatively, to make the rider's effectiveness subject to refund. The ICC denied the AG's motion for stay on October 20, 2010. The pending appeals are unaffected by the ICC's action.

On September 30, 2010, the Illinois Appellate Court, Second District, issued a decision which, among other things, rejected the ICC's approval of a Commonwealth Edison Company (ComEd) cost recovery mechanism for system modernization in the form of advanced metering technology (also called "smart grid") because it was improper single issue ratemaking. Single issue ratemaking is one of the arguments raised in the pending appeal of NSG's and PGL's decoupling mechanism before the Appellate Court, First District, and that the opponents of Rider ICR raised at the ICC and are expected to raise before that court. Integrys Energy Group is evaluating the decision of the Illinois Appellate Court, Second District, in light of other, contrary precedents, and whether differences in the decoupling mechanism and Rider ICR distinguish them from ComEd's rider.

2009 Illinois Legislation

In July 2009, Illinois Senate Bill (SB) 1918 was signed into law. SB 1918 contains a provision that allows PGL and NSG to file a rider to recover (or refund) the incremental difference between the rate case authorized uncollectible expense and the actual uncollectible expense reported to the ICC each year. PGL and NSG filed their respective riders with the ICC in September 2009, and began recording the effects of this provision at that time. The ICC approved the rider in February 2010. SB 1918 also requires a percentage of income payment plan for low-income utility customers, which PGL and NSG are offering as a transition program in 2010 and 2011, with a permanent program to begin no later than September 1, 2011. Additionally, SB 1918 requires an on-bill financing program that PGL and NSG filed in February 2010, with a requested June 2011 effective date, that the ICC approved in June 2010. The on-bill financing program will allow certain residential customers of PGL and NSG to borrow funds from a third party lender to purchase energy efficiency measures and pay back the borrowed funds over time through a charge on their utility bill. Finally, SB 1918 requires an EEP to meet specified energy efficiency standards, which PGL and NSG filed with the ICC for approval on September 30, 2010, with the first program year beginning June 2011.

2008 Rates

On February 5, 2008, the ICC issued a final order authorizing a retail natural gas rate increase of \$71.2 million for PGL and a retail natural gas rate decrease of \$0.2 million for NSG, effective February 14, 2008. The rates for PGL reflected a 10.19% return on common equity and a common equity

ratio of 56% in its regulatory capital structure. The rates for NSG reflected a 9.99% return on common equity and a common equity ratio of 56% in its regulatory capital structure. The order included approval of a decoupling mechanism, effective March 1, 2008, as a four-year pilot program, which allows PGL and NSG to adjust rates going forward to recover or refund the difference between the actual and authorized margin impact of variations in volumes. Legislation was introduced, but not enacted, at the Illinois state legislature to roll back decoupling. Integrys Energy Group actively supports the ICC's decision to approve this rate setting mechanism. The order also approved an EEP, which allows PGL and NSG to recover up to \$6.4 million and \$1.1 million per year, respectively, of energy efficiency costs. This EEP is separate from, and will be replaced by, the SB 1918 required EEP.

On March 26, 2008, the ICC denied PGL's and NSG's request for rehearing of their rate orders, and all but one such request from interveners, which only affected PGL. The ICC approved a stipulation resolving the rehearing issue. Following the stipulation approval, PGL and NSG and four other parties filed appeals with the Illinois appellate court. Issues on appeal include the decoupling mechanism.

Minnesota

2010 Rates

On December 4, 2009, the MPUC approved a final written order authorizing MERC a retail natural gas rate increase of \$15.4 million, effective January 1, 2010. The new rates reflect a 10.21% return on common equity and a common equity ratio of 48.77% in its regulatory capital structure. Since the final approved rate increase was lower than the interim rate increase that went into effect in October 2008, refunds of \$5.5 million were made to customers in March 2010.

Federal

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

For the 16-month transitional period, Integrys Energy Services received billings of \$19.2 million (pre-tax) for these charges. Integrys Energy Services initially expensed \$14.7 million of the \$19.2 million, as it was considered probable that Integrys Energy Services' total exposure would be reduced by at least \$4.5 million due to inconsistencies between the FERC's SECA order and the transmission owners' compliance filings. Subsequent to receiving the billings, Integrys Energy Services reached settlement agreements with three of its vendors for a combined \$1.6 million, which reduced the \$4.5 million original receivable balance to approximately \$3 million.

In August 2006, the administrative law judge hearing the case issued an Initial Decision that was in substantial agreement with all of Integrys Energy Services' positions, and on May 21, 2010, the FERC issued its Final Order on the Initial Decision. In the Final Order, the FERC ruled favorably for Integrys Energy Services on two issues, which are anticipated to result in additional refunds of approximately \$2 million, but reversed the rulings of the Initial Decision on nearly every other substantive issue. As a result of this ruling, Integrys Energy Services expensed, as a component of margin, an additional approximately \$1 million in the second quarter of 2010, as only approximately \$2 million of the approximate \$3 million receivable balance remained probable of collection from counterparties. Integrys Energy Services and numerous other parties filed for rehearing of the FERC's Final Order. A number of related orders will be considered for judicial review. Any refunds to Integrys Energy Services will include interest for the period from payment to refund.

NOTE 24--SEGMENTS OF BUSINESS

At September 30, 2010, Integrys Energy Group reported five segments, which are described below.

- The natural gas utility segment includes the regulated natural gas utility operations of WPS, MGU, MERC, PGL, and NSG.
- The electric utility segment includes the regulated electric utility operations of WPS and UPPCO.
- The electric transmission investment segment includes Integrys Energy Group's approximate 34% ownership interest in ATC. ATC is a federally regulated electric transmission company operating in Wisconsin, Michigan, Minnesota, and Illinois.
- Integrys Energy Services is a diversified nonregulated natural gas and electric power supply and services company serving retail customers (residential, commercial, and industrial).
- The holding company and other segment includes the operations of the Integrys Energy Group holding company and the PEC holding company, along with any nonutility activities at WPS, MGU, MERC, UPPCO, PGL, NSG, and IBS. Equity earnings from Integrys Energy Group's investment in WRPC are also included in the holding company and other segment.

The tables below present information for the respective periods pertaining to Integrys Energy Group's reportable segments:

<i>(Millions)</i>	<u>Regulated Operations</u>			Total Regulated Operations	<u>Nonutility and Nonregulated Operations</u>		Reconciling Eliminations	Integrys Energy Group Consolidated
	Natural Gas Utility	Electric Utility	Electric Transmission Investment		Integrys Energy Services	Holding Company and Other		
Three Months Ended September 30, 2010								
External revenues	\$234.1	\$364.5	\$ -	\$598.6	\$396.3	\$ 3.0	\$ -	\$997.9
Intersegment revenues	0.2	10.0	-	10.2	-	-	(10.2)	-
Impairment losses on property, plant, and equipment	-	-	-	-	43.2	-	-	43.2
Restructuring income	-	(0.2)	-	(0.2)	(0.1)	-	-	(0.3)
Net gain on Integrys Energy Services' dispositions related to strategy change	-	-	-	-	(0.2)	-	-	(0.2)
Depreciation and amortization expense	34.9	22.8	-	57.7	4.8	6.5	-	69.0
Miscellaneous income (expense)	0.5	0.4	19.2	20.1	5.1	10.4	(9.3)	26.3
Interest expense (income)	12.5	10.8	-	23.3	1.0	20.2	(9.3)	35.2
(Benefit) provision for income taxes	(16.8)	24.6	7.7	15.5	(4.2)	(2.0)	-	9.3
Net (loss) income from continuing operations	(24.2)	46.0	11.5	33.3	(7.7)	(4.7)	-	20.9
Preferred stock dividends of subsidiary	(0.2)	(0.5)	-	(0.7)	-	-	-	(0.7)
Net (loss) income attributed to common shareholders	(24.4)	45.5	11.5	32.6	(7.7)	(4.7)	-	20.2

	<u>Regulated Operations</u>				<u>Nonutility and Nonregulated Operations</u>			<u>Integrys Energy Group Consolidated</u>
	<u>Natural Gas Utility</u>	<u>Electric Utility</u>	<u>Electric Transmission Investment</u>	<u>Total Regulated Operations</u>	<u>Integrys Energy Services</u>	<u>Holding Company and Other</u>	<u>Reconciling Eliminations</u>	
(Millions)								
Three Months Ended September 30, 2009								
External revenues	\$211.5	\$332.3	\$ -	\$543.8	\$751.2	\$ 2.8	\$ -	\$1,297.8
Intersegment revenues	0.1	10.0	-	10.1	-	-	(10.1)	-
Restructuring expense	-	-	-	-	2.4	-	-	2.4
Net loss on Integrys Energy Services' dispositions related to strategy change	-	-	-	-	0.2	-	-	0.2
Depreciation and amortization expense	26.4	22.4	-	48.8	4.9	3.8	-	57.5
Miscellaneous income (expense)	1.0	1.7	19.3	22.0	3.2	11.3	(11.0)	25.5
Interest expense (income)	12.6	10.1	-	22.7	4.2	25.8	(11.0)	41.7
(Benefit) provision for income taxes	(11.9)	21.8	7.7	17.6	22.3	(11.9)	-	28.0
Net (loss) income from continuing operations	(19.7)	38.8	11.6	30.7	21.1	(2.7)	-	49.1
Discontinued operations	-	-	-	-	2.3	-	-	2.3
Preferred stock dividends of subsidiary	(0.2)	(0.5)	-	(0.7)	-	-	-	(0.7)
Noncontrolling interest in subsidiaries	-	-	-	-	0.4	-	-	0.4
Net (loss) income attributed to common shareholders	(19.9)	38.3	11.6	30.0	23.8	(2.7)	-	51.1

	<u>Regulated Operations</u>				<u>Nonutility and Nonregulated Operations</u>			<u>Integrys Energy Group Consolidated</u>
	<u>Natural Gas Utility</u>	<u>Electric Utility</u>	<u>Electric Transmission Investment</u>	<u>Total Regulated Operations</u>	<u>Integrys Energy Services</u>	<u>Holding Company and Other</u>	<u>Reconciling Eliminations</u>	
(Millions)								
Nine Months Ended September 30, 2010								
External revenues	\$1,457.5	\$1,008.5	\$ -	\$2,466.0	\$1,441.1	\$ 9.0	\$ -	\$3,916.1
Intersegment revenues	0.5	21.7	-	22.2	1.0	-	(23.2)	-
Impairment losses on property, plant, and equipment	-	-	-	-	43.2	-	-	43.2
Restructuring (income) expense	(0.1)	(0.3)	-	(0.4)	9.1	0.2	-	8.9
Net loss on Integrys Energy Services' dispositions related to strategy change	-	-	-	-	14.6	-	-	14.6
Depreciation and amortization expense	98.2	71.8	-	170.0	14.0	17.1	-	201.1
Miscellaneous income (expense)	1.3	0.9	57.9	60.1	8.0	33.7	(30.7)	71.1
Interest expense (income)	38.4	32.3	-	70.7	5.8	65.4	(30.7)	111.2
Provision (benefit) for income taxes	38.6	56.5	23.3	118.4	(5.3)	(9.2)	-	103.9
Net income (loss) from continuing operations	44.1	99.6	34.6	178.3	(11.0)	(16.8)	-	150.5
Discontinued operations	-	-	-	-	0.1	-	-	0.1
Preferred stock dividends of subsidiary	(0.5)	(1.8)	-	(2.3)	-	-	-	(2.3)
Noncontrolling interest in subsidiaries	-	-	-	-	0.3	-	-	0.3
Net income (loss) attributed to common shareholders	43.6	97.8	34.6	176.0	(10.6)	(16.8)	-	148.6

(Millions)	Regulated Operations				Nonutility and Nonregulated Operations		Reconciling Eliminations	Integrys Energy Group Consolidated
	Natural Gas Utility	Electric Utility	Electric Transmission Investment	Total Regulated Operations	Integrys Energy Services	Holding Company and Other		
Nine Months Ended September 30, 2009								
External revenues	\$1,616.8	\$954.1	\$ -	\$2,570.9	\$3,346.7	\$ 8.6	\$ -	\$5,926.2
Intersegment revenues	0.4	32.2	-	32.6	1.1	-	(33.7)	-
Goodwill impairment loss	291.1	-	-	291.1	-	-	-	291.1
Impairment losses on property, plant, and equipment	-	-	-	-	0.7	-	-	0.7
Restructuring expense	-	-	-	-	21.5	-	-	21.5
Net loss on Integrys Energy Services' dispositions related to strategy change	-	-	-	-	0.2	-	-	0.2
Depreciation and amortization expense	78.8	67.4	-	146.2	14.7	11.1	-	172.0
Miscellaneous income (expense)	2.8	3.9	55.7	62.4	5.2	35.3	(35.7)	67.2
Interest expense (income)	38.8	31.1	-	69.9	9.9	80.3	(35.7)	124.4
(Benefit) provision for income taxes	(10.2)	48.2	22.3	60.3	15.9	(16.9)	-	59.3
Net (loss) income from continuing operations	(196.6)	90.1	33.4	(73.1)	2.8	(25.1)	-	(95.4)
Discontinued operations	-	-	-	-	2.6	-	-	2.6
Preferred stock dividends of subsidiary	(0.5)	(1.8)	-	(2.3)	-	-	-	(2.3)
Noncontrolling interest in subsidiaries	-	-	-	-	0.7	-	-	0.7
Net (loss) income attributed to common shareholders	(197.1)	88.3	33.4	(75.4)	6.1	(25.1)	-	(94.4)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the accompanying condensed consolidated financial statements and related notes and Integrys Energy Group's Annual Report on Form 10-K for the year ended December 31, 2009.

SUMMARY

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

RESULTS OF OPERATIONS

<i>(Millions, except per share amounts)</i>	Three Months Ended September 30		Change in 2010 Over 2009	Nine Months Ended September 30		Change in 2010 Over 2009
	2010	2009		2010	2009	
Natural gas utility operations	\$(24.4)	\$(19.9)	22.6 %	\$ 43.6	\$(197.1)	N/A
Electric utility operations	45.5	38.3	18.8 %	97.8	88.3	10.8 %
Electric transmission investment	11.5	11.6	(0.9)%	34.6	33.4	3.6 %
Integrys Energy Services' operations	(7.7)	23.8	N/A	(10.6)	6.1	N/A
Holding company and other operations	(4.7)	(2.7)	74.1 %	(16.8)	(25.1)	(33.1)%
Net income (loss) attributed to common shareholders	\$ 20.2	\$ 51.1	(60.5)%	\$148.6	\$ (94.4)	N/A
Basic earnings (loss) per share	\$0.26	\$0.67	(61.2)%	\$1.92	\$(1.23)	N/A
Diluted earnings (loss) per share	\$0.26	\$0.66	(60.6)%	\$1.91	\$(1.23)	N/A
Average shares of common stock						
Basic	77.7	76.8	1.2 %	77.3	76.8	0.7 %
Diluted	78.1	76.9	1.6 %	77.8	76.8	1.3 %

Summary of Financial Results – Third Quarter 2010 Compared with Third Quarter 2009

Integrys Energy Group recognized net income attributed to common shareholders of \$20.2 million (\$0.26 diluted earnings per share) for the quarter ended September 30, 2010, compared with net income attributed to common shareholders of \$51.1 million (\$0.66 diluted earnings per share) for the quarter ended September 30, 2009. Significant factors impacting the \$30.9 million decrease in earnings were as follows (and are discussed in more detail thereafter):

- The net loss at the regulated natural gas utility segment increased \$4.5 million, driven primarily by higher operating expenses. Higher operating expenses included a \$5.1 million after-tax increase in depreciation and amortization expense related to a change in recovery method under a recent rate order, a \$3.2 million after-tax increase in employee benefit costs, a \$2.8 million after-tax increase in bad debt expense, a \$2.3 million after-tax increase in stock-based compensation expense, and a \$2.0 million after-tax increase related to energy efficiency initiatives. Lower quarter-over-quarter residential throughput volumes also contributed \$1.8 million after-tax to the increase in net loss. Partially offsetting the higher net loss was a \$12.0 million after-tax increase from rates implemented at certain regulated natural gas utilities in the first quarter of 2010, which were necessary, in part, for recovery of higher operating expenses.

- Earnings at the regulated electric utility segment increased \$7.2 million, driven by a \$15.0 million after-tax increase in margins, primarily related to an increase in sales volumes to residential customers and retail rate increases at WPS and UPPCO, which were necessary, in part, for recovery of higher operating expenses. The increase in margins was partially offset by a \$7.6 million after-tax increase in operating and maintenance expense, primarily related to increases in employee benefit costs, customer assistance expense, and stock-based compensation expense.
- Earnings at the electric transmission investment segment decreased \$0.1 million, due to a decrease in income from Integrys Energy Group's ownership interest in ATC.
- Earnings at Integrys Energy Services decreased \$31.5 million, driven by a \$25.9 million after-tax non-cash impairment loss on three natural gas-fired generation plants, and an \$18.7 million after-tax decrease in margins. Margins from the retail electric and natural gas businesses that Integrys Energy Services will retain as part of its revised strategy increased quarter-over-quarter, but were more than offset by a decrease in realized margin from retail and wholesale electric and natural gas businesses that are not part of Integrys Energy Service's revised strategy (and were either divested of, exited, or are in the process of being exited). These decreases in earnings were partially offset by a \$6.4 million after-tax decrease in operating and maintenance expense, an approximate \$4 million positive quarter-over-quarter impact of a change in the effective tax rate attributed to several discrete tax items in the third quarter 2009 provision for income taxes, primarily related to Integrys Energy Services' strategy change, a \$3.1 million after-tax increase in other income, and a \$1.5 million after-tax decrease in restructuring expense.
- The net loss at the holding company and other segment increased \$2.0 million, driven by the approximate \$7 million negative quarter-over-quarter impact of adjustments to the effective tax rate required by GAAP in the third quarter of 2009 to ensure the year-to-date interim effective tax rate reflected the projected annual effective tax rate. The increase in net loss was partially offset by a \$3.4 million after-tax decrease in external interest expense.

Summary of Financial Results – Nine Months 2010 Compared with Nine Months 2009

Integrys Energy Group recognized net income attributed to common shareholders of \$148.6 million (\$1.91 diluted earnings per share) for the nine months ended September 30, 2010, compared with a net loss attributed to common shareholders of \$94.4 million (\$1.23 net loss per share) for the nine months ended September 30, 2009. Significant factors impacting the \$243.0 million increase in earnings were as follows (and are discussed in more detail thereafter):

- Earnings at the regulated natural gas utility segment increased \$240.7 million, driven primarily by the positive period-over-period impact on earnings of a \$248.8 million after-tax non-cash goodwill impairment loss recorded in the first quarter of 2009. Earnings also increased \$40.2 million after-tax from rate increases implemented at certain regulated natural gas utilities in the first quarter of 2010, which were necessary, in part, for recovery of higher operating expenses. Savings in labor costs of \$3.1 million after-tax as a result of a reduction in workforce and company-wide furloughs also positively impacted earnings. Partially offsetting these increases were a \$14.4 million after-tax decrease in earnings related to lower period-over-period volumes, a \$6.5 million non-cash increase in provision for income taxes related to the 2010 federal health care legislation, and higher operating expenses. Higher operating expenses included an \$11.6 million after-tax increase in depreciation and amortization expense related to a change in recovery method under a recent rate order, an \$8.8 million after-tax increase in employee benefit costs, a \$5.1 million after-tax increase related to energy efficiency initiatives, a \$2.8 million after-tax increase in stock-based compensation expense, and a \$2.6 million after-tax increase in intercompany depreciation and cost of capital charges.

- Earnings at the regulated electric utility segment increased \$9.5 million, driven by a \$28.5 million after-tax increase in margins, primarily related to lower fuel and purchased power costs incurred during the first nine months of 2010 (as compared with authorized fuel and purchased power cost recovery rates), as well as retail rate increases at WPS and UPPCO, which were necessary, in part, for recovery of higher operating expenses. The increase in margins was partially offset by a \$15.3 million after-tax increase in operating expenses, primarily related to increases in electric transmission expense, customer assistance expense, and employee benefit costs. In addition, the 2010 federal health care legislation resulted in a \$4.5 million non-cash increase to the provision for income taxes at the electric utility segment.
- Earnings at the electric transmission investment segment increased \$1.2 million, due to an increase in income from Integrys Energy Group's ownership interest in ATC.
- Earnings at Integrys Energy Services decreased \$16.7 million, driven by a \$35.2 million after-tax decrease in margins, primarily related to reduced business size as a result of Integrys Energy Services' strategy change, a \$25.9 million after-tax non-cash impairment loss on three natural gas-fired generation plants in the third quarter of 2010, and an \$8.6 million net after-tax increase in loss on dispositions, which primarily resulted from mark-to-market timing differences that have historically caused earnings volatility at Integrys Energy Services. These decreases in earnings were partially offset by a \$35.8 million after-tax decrease in operating and maintenance expense, a \$7.4 million after-tax decrease in restructuring expense, an approximate \$7 million positive period-over-period impact of a change in the effective tax rate attributed to several discrete tax items in the 2009 provision for income taxes, primarily related to Integrys Energy Services' strategy change, and a \$4.1 million after-tax increase in other income.
- The net loss at the holding company and other segment decreased \$8.3 million, driven by a \$7.4 million after-tax decrease in external interest expense.

Utility Operations

For all periods presented, utility operations included the regulated natural gas utility segment, consisting of the regulated natural gas operations of PGL, WPS, MERC, MGU, and NSG, and the regulated electric segment, consisting of the regulated electric operations of WPS and UPPCO.

Regulated Natural Gas Utility Segment Operations

<i>(Millions, except heating degree days)</i>	Three Months Ended September 30		Change in 2010 Over 2009	Nine Months Ended September 30		Change in 2010 Over 2009
	2010	2009		2010	2009	
Revenues	\$234.3	\$211.6	10.7 %	\$1,457.9	\$1,617.2	(9.9)%
Purchased natural gas costs	89.2	84.1	6.1 %	817.6	1,002.8	(18.5)%
Margins	145.1	127.5	13.8 %	640.3	614.4	4.2 %
Operating and maintenance expense	130.9	112.2	16.7 %	397.0	390.1	1.8 %
Goodwill impairment loss *	-	-	-	-	291.1	(100.0)%
Depreciation and amortization expense	34.9	26.4	32.2 %	98.2	78.8	24.6 %
Taxes other than income taxes	8.3	8.9	(6.7)%	25.3	25.2	0.4 %
Operating income (loss)	(29.0)	(20.0)	45.0 %	119.8	(170.8)	N/A
Miscellaneous income	0.5	1.0	(50.0)%	1.3	2.8	(53.6)%
Interest expense	(12.5)	(12.6)	(0.8)%	(38.4)	(38.8)	(1.0)%
Other expense	(12.0)	(11.6)	3.4 %	(37.1)	(36.0)	3.1 %
Income (loss) before taxes	\$ (41.0)	\$(31.6)	29.7 %	\$ 82.7	\$ (206.8)	N/A
Throughput in therms						
Residential	92.6	94.7	(2.2)%	992.0	1,107.3	(10.4)%
Commercial and industrial	35.9	35.6	0.8 %	309.1	353.0	(12.4)%
Interruptible	3.6	3.9	(7.7)%	25.3	28.0	(9.6)%
Interdepartmental	6.6	3.5	88.6 %	11.9	7.9	50.6 %
Transport	312.8	248.1	26.1 %	1,226.1	1,157.6	5.9 %
Total sales in therms	451.5	385.8	17.0 %	2,564.4	2,653.8	(3.4)%
Weather						
Average heating degree days	134	134	-	3,996	4,573	(12.6)%

* See Note 9, "Goodwill and Other Intangible Assets," for more information.

Third Quarter 2010 Compared with Third Quarter 2009

Revenues

Regulated natural gas utility segment revenues increased \$22.7 million quarter-over-quarter, driven by:

- An approximate \$20 million positive impact of retail natural gas distribution rate increases at the regulated natural gas utilities. These rate increases were necessary, in part, to recover higher operating expenses at the regulated natural gas utility segment (as discussed below). See Note 23, "Regulatory Environment," for more information on these rate increases.
 - PGL and NSG received final rate increases from the ICC for retail natural gas distribution rates that were effective January 28, 2010, which had an approximate \$17 million positive impact on revenues.
 - WPS received a final rate increase from the PSCW for retail natural gas distribution rates that was effective January 1, 2010, which had an approximate \$2 million positive impact on revenues.
 - MGU received a final rate increase from the MPSC for retail natural gas distribution rates that was effective January 1, 2010, which had an approximate \$1 million positive impact on revenues.

- An approximate \$9 million increase as a result of an approximate 10% increase in the average per-unit cost of natural gas sold by the regulated natural gas utilities during the quarter ended September 30, 2010, compared with the same quarter in 2009. For all of Integrys Energy Group's regulated natural gas utilities, prudently incurred natural gas commodity costs are passed directly through to customers in current rates.
- A partially offsetting approximate \$6 million decrease in revenues resulting from the 2.2% decrease in natural gas throughput volumes to residential customers. This decrease in revenues resulted from an approximate \$11 million decrease attributed to customer conservation, efficiency efforts, and general economic conditions, partially offset by an approximate \$5 million positive impact related to adjustments to estimated unbilled revenues resulting from the annual true-up process at WPS.

Margins

Regulated natural gas utility segment margins increased \$17.6 million quarter-over-quarter, driven by:

- The approximate \$20 million positive impact of rate increases at the regulated natural gas utilities.
- A partially offsetting approximate \$3 million net decrease in margins resulting primarily from lower natural gas throughput volumes sold to residential customers. This decrease reflects the positive impact related to adjustments to estimated unbilled revenues resulting from the annual true-up process at WPS.

Operating Loss

The operating loss at the regulated natural gas utility segment increased \$9.0 million quarter-over-quarter, driven by a \$26.6 million increase in operating expenses, partially offset by the \$17.6 million increase in natural gas utility margins.

The \$26.6 million quarter-over-quarter increase in operating expenses was driven by:

- An \$8.5 million increase in depreciation and amortization expense, primarily related to the ICC's rate order for PGL and NSG, effective January 28, 2010, which allows up front recovery in rates for net dismantling costs by including them as a component of depreciation rates applied to natural gas distribution assets. The increase also includes a loss on retirement for MGU assets for which rate recovery is uncertain.
- A \$5.3 million increase in employee benefit costs, partially related to an increase in pension and post-retirement medical expenses, driven by the amortization of negative investment returns on plan assets from prior years.
- A \$4.6 million net increase in bad debt expense, primarily related to PGL's and NSG's 2009 election under an Illinois law to file to recover from or refund to customers the difference between actual bad debt expense reported as a component of earnings and bad debt expense included in utility rates retroactive to January 1, 2008. This increase in bad debt expense was partially offset by the positive impact on accounts receivable resulting from a decrease in past due account balances at the regulated natural gas utilities. See Note 23, "*Regulatory Environment*," for more information on bad debt recovery mechanisms.
- A \$3.8 million increase in stock-based compensation expense. See Note 17, "*Stock-Based Compensation*," for more information.
- A \$3.4 million increase in operating expenses related to energy conservation programs and enhanced efficiency initiatives.

- A \$1.9 million increase in intercompany depreciation and cost of capital charges from IBS related to implementation of both a work asset management system for natural gas operations and a newer version of an Enterprise Resource Planning (ERP) system for finance and supply chain.
- A partially offsetting \$2.6 million decrease in labor costs, driven by the reduction in workforce and company-wide furloughs implemented as part of previously announced cost management efforts.

Nine Months 2010 Compared with Nine Months 2009

Revenues

Regulated natural gas utility segment revenues decreased \$159.3 million period-over-period, driven by:

- An approximate \$132 million decrease in revenues as a result of lower natural gas throughput volumes, related to:
 - An approximate \$89 million decrease as a result of warmer period-over-period weather during the heating season, evidenced by the 12.6% decrease in average heating degree days.
 - An approximate \$57 million decrease driven by lower weather normalized volumes. Residential customer volumes decreased, which Integrys Energy Group attributes to customer conservation, efficiency efforts, and general economic conditions. Commercial and industrial customer volumes also decreased, which Integrys Energy Group attributes to reduced demand related to changes in customers' business operations and general economic conditions.
 - A partially offsetting approximate \$12 million positive period-over-period impact of decoupling mechanisms for residential, small commercial and industrial, and transportation customers, primarily at PGL and WPS. Under decoupling, PGL, NSG, MGU, and WPS are allowed to defer the difference between the actual and rate case authorized delivery charge components of margin from certain customers and adjust future rates in accordance with rules applicable to each jurisdiction.
 - A partially offsetting approximate \$2 million positive impact related to adjustments to estimated unbilled revenues resulting from the annual true-up process at WPS.
- An approximate \$78 million decrease as a result of an approximate 8% decrease in the average per-unit cost of natural gas sold by the regulated natural gas utilities during the nine months ended September 30, 2010, compared with the same period in 2009. For all of Integrys Energy Group's regulated natural gas utilities, prudently incurred natural gas commodity costs are passed directly through to customers in current rates.
- An approximate \$22 million decrease from lower recovery of environmental cleanup expenditures related to former manufactured gas plant sites, partially offset by a \$5 million increase in revenues related to recoveries received under the PGL and NSG bad debt rider, which was approved in February 2010. Recoveries in 2010 under the bad debt rider represent billings to customers of the net excess of actual 2008 and 2009 bad debt expense over bad debt expense reflected in utility rates during those same periods. The net \$17 million decrease in revenues relating to these two items was offset by a decrease in operating and maintenance expense from the amortization of the related regulatory assets and, therefore, had no impact on earnings. See Note 23, "Regulatory Environment," for more information on the PGL and NSG bad debt rider.
- A partially offsetting approximate \$67 million positive impact of natural gas distribution rate increases at the regulated natural gas utilities. These rate increases were necessary, in part, to recover higher operating expenses at the regulated natural gas segment (as discussed below). See Note 23, "Regulatory Environment," for more information on these rate increases.

- PGL and NSG received final rate increases from the ICC for retail natural gas distribution rates that were effective January 28, 2010, which had an approximate \$54 million positive impact on revenues.
- WPS received a final rate increase from the PSCW for retail natural gas distribution rates that was effective January 1, 2010, which had an approximate \$10 million positive impact on revenues.
- MGU received a final rate increase from the MPSC for retail natural gas distribution rates that was effective January 1, 2010, which had an approximate \$3 million positive impact on revenues.

Margins

Regulated natural gas utility segment margins increased \$25.9 million period-over-period, driven by:

- The approximate \$67 million positive impact of rate increases at the regulated natural gas utilities.
- A partially offsetting approximate \$24 million decrease in margins resulting from the 3.4% decrease in natural gas throughput volumes. This decrease in margins was a result of:
 - An approximate \$23 million decrease related to warmer period-over-period weather.
 - An approximate \$15 million decrease related to lower weather normalized volumes, attributed to customer conservation, efficiency efforts, and general economic conditions.
 - A partially offsetting approximate \$12 million positive impact from decoupling mechanisms in place at PGL, NSG, MGU, and WPS. The decoupling mechanism for WPS's natural gas utility includes an annual \$8.0 million cap for the deferral of any excess or shortfall from the rate case authorized margin. This cap was reached prior to the end of the first quarter of 2010 but was not reached during 2009, which resulted in WPS realizing approximately \$7 million less margins period-over-period from lower sales volumes with no offsetting decoupling to mitigate these lower volumes.
 - A partially offsetting approximate \$2 million positive impact related to adjustments to estimated unbilled revenues resulting from the annual true-up process at WPS.
- A partially offsetting approximate \$22 million decrease in margins from lower recovery of environmental cleanup expenditures related to former manufactured gas plant sites, partially offset by a \$5 million increase in margins related to recoveries received under the PGL and NSG bad debt rider, which was approved in February 2010.

Operating Income (Loss)

Operating income at the regulated natural gas utility segment increased \$290.6 million, from an operating loss of \$170.8 million during the nine months ended September 30, 2009, to operating income of \$119.8 million during the same period in 2010. This increase was primarily driven by the positive period-over-period impact of a \$291.1 million non-cash goodwill impairment loss that was recorded in the first quarter of 2009. Also contributing to the increase was the \$25.9 million increase in the regulated natural gas utility margins, partially offset by a \$26.4 million increase in other operating expenses. See Note 9, "Goodwill and Other Intangible Assets," for information related to the goodwill impairment loss recorded in 2009.

The \$26.4 million period-over-period increase in other operating expenses primarily related to:

- A \$19.4 million increase in depreciation and amortization expense, primarily related to the ICC's rate order for PGL and NSG, effective January 28, 2010, which allows up front recovery in rates for net dismantling costs by including them as a component of depreciation rates applied to natural gas distribution assets. The increase also includes a loss on retirement for MGU assets for which rate recovery is uncertain.
- A \$14.7 million increase in employee benefit costs, partially related to an increase in pension and post-retirement medical expenses, driven by the amortization of negative investment returns on plan assets from prior years.
- An \$8.5 million increase in operating expenses related to energy conservation programs and enhanced efficiency initiatives.
- A \$4.6 million increase in stock-based compensation expense. See Note 17, "*Stock-Based Compensation*," for more information.
- A \$4.4 million increase in intercompany depreciation and cost of capital charges from IBS related to implementation of both a work asset management system for natural gas operations and a newer version of an ERP system for finance and supply chain.
- These increases were partially offset by:
 - An approximate \$22 million decrease in amortization of the regulatory asset related to environmental cleanup expenditures of manufactured gas plant sites, partially offset by amortization of approximately \$5 million of the regulatory asset related to the PGL and NSG bad debt rider. The net \$17 million decrease in operating and maintenance expense related to these two items was recovered from customers in rates and, therefore, had no impact on earnings.
 - A \$5.2 million decrease in labor costs as a result of the reduction in workforce and company-wide furloughs implemented as a part of previously announced cost management efforts.
 - A \$3.1 million net decrease in bad debt expense, primarily related to the positive impact lower volumes and lower energy prices had on overall accounts receivable balances and a decrease in past due account balances. This net decrease reflects the current year impact of the bad debt riders for PGL, NSG, and MGU. It also reflects the impact of the third quarter of 2009 bad debt expense reduction resulting from PGL's and NSG's 2009 election under an Illinois law to file to recover from or refund to customers the difference between actual bad debt expense reported as a component of earnings and bad debt expense included in utility rates retroactive to January 1, 2008.

Regulated Electric Utility Segment Operations

<i>(Millions, except heating degree days)</i>	Three Months Ended		Change in 2010 Over 2009	Nine Months Ended		Change in 2010 Over 2009
	September 30			September 30		
	2010	2009		2010	2009	
Revenues	\$374.5	\$342.3	9.4 %	\$1,030.3	\$986.3	4.5 %
Fuel and purchased power costs	154.4	147.2	4.9 %	431.4	434.9	(0.8)%
Margins	220.1	195.1	12.8 %	598.9	551.4	8.6 %
Operating and maintenance expense	105.0	92.3	13.8 %	305.3	283.7	7.6 %
Depreciation and amortization expense	22.8	22.4	1.8 %	71.8	67.4	6.5 %
Taxes other than income taxes	11.3	11.4	(0.9)%	34.3	34.8	(1.4)%
Operating income	81.0	69.0	17.4 %	187.5	165.5	13.3 %
Miscellaneous income	0.4	1.7	(76.5)%	0.9	3.9	(76.9)%
Interest expense	(10.8)	(10.1)	6.9 %	(32.3)	(31.1)	3.9 %
Other expense	(10.4)	(8.4)	23.8 %	(31.4)	(27.2)	15.4 %
Income before taxes	\$ 70.6	\$ 60.6	16.5 %	\$ 156.1	\$138.3	12.9 %
Sales in kilowatt-hours						
Residential	882.0	765.7	15.2 %	2,358.9	2,275.4	3.7 %
Commercial and industrial	2,212.7	2,138.7	3.5 %	6,358.7	6,113.6	4.0 %
Wholesale	1,392.1	1,376.2	1.2 %	3,851.9	3,718.8	3.6 %
Other	8.5	8.7	(2.3)%	27.7	28.3	(2.1)%
Total sales in kilowatt-hours	4,495.3	4,289.3	4.8 %	12,597.2	12,136.1	3.8 %
Weather						
WPS:						
Heating degree days	227	225	0.9 %	4,415	5,261	(16.1)%
Cooling degree days	478	163	193.3 %	616	274	124.8 %
UPPCO:						
Heating degree days	430	458	(6.1)%	5,132	6,249	(17.9)%
Cooling degree days	244	60	306.7 %	301	99	204.0 %

Third Quarter 2010 Compared with Third Quarter 2009

Revenues

Regulated electric utility segment revenues increased \$32.2 million quarter-over-quarter, driven by:

- An approximate \$18 million increase in revenues due to an increase in sales volumes of 15.2% to residential customers and 2.7% to small commercial and industrial customers, primarily related to warmer period-over-period weather during the cooling season as evidenced by the increase in cooling degree days.
- An approximate \$9 million combined positive impact of retail electric rate increases at both WPS and UPPCO, effective January 1, 2010. These rate increases were necessary, in part, for recovery of higher operating expenses.
- An approximate \$4 million increase in revenues due to a 7.4% increase in sales volumes to large commercial and industrial customers at WPS related to changes in business operations, which Integrys Energy Group attributes mainly to improved economic conditions in WPS's service territory quarter-over-quarter.

Margins

Regulated electric utility segment margins increased \$25.0 million quarter-over-quarter, driven by:

- An approximate \$11 million increase in margins due to a 15.2% increase in sales volumes to residential customers, primarily related to warmer quarter-over-quarter weather during the cooling season as evidenced by the increase in cooling degree days. WPS reached the annual \$14.0 million electric decoupling cap in the second quarter of 2010 and 2009 and remained over the cap through the end of the third quarter in both years. As a result, the decoupling rate design had no impact on quarter-over-quarter margins for WPS.
- An approximate \$9 million combined positive impact of retail electric rate increases at both WPS and UPPCO, effective January 1, 2010.
- An approximate \$3 million increase in margins related to fuel and purchased power costs at WPS, primarily driven by lower fuel and purchased power costs incurred during the third quarter of 2010 (as compared with authorized fuel and purchased power cost recovery rates).
- An approximate \$2 million increase in margins due to a 7.4% increase in sales volumes to large commercial and industrial customers at WPS related to changes in business operations, which Integrys Energy Group attributes mainly to improved economic conditions in WPS's service territory quarter-over-quarter.

Operating Income

Operating income at the regulated electric utility segment increased \$12.0 million quarter-over-quarter, driven by the \$25.0 million increase in margins, partially offset by a \$12.7 million increase in operating and maintenance expense.

The increase in operating and maintenance expense was the result of:

- A \$4.3 million increase in employee benefit costs, primarily related to an increase in pension and other postretirement benefit expenses, driven by the amortization of negative investment returns on plan assets from prior years.
- A \$3.3 million increase in customer assistance expense related to payments made to the Focus on Energy program, which helps residents and businesses install cost-effective, energy efficient, and renewable energy products.
- A \$3.3 million increase in stock-based compensation expense. See Note 17, "Stock-Based Compensation," for more information.
- A \$3.0 million increase in electric transmission expense.
- These increases in regulated electric utility operating expenses were partially offset by a \$1.3 million decrease in labor costs, driven by the reduction in workforce and company-wide furloughs implemented as part of previously announced cost management efforts.

Other Expense

Other expense at the regulated electric utilities increased \$2.0 million, driven by a \$2.0 million decrease in AFUDC related to the Crane Creek Wind Farm.

Nine Months 2010 Compared with Nine Months 2009

Revenues

Regulated electric utility segment revenues increased \$44.0 million period-over-period, driven by:

- An approximate \$16 million combined positive impact of retail electric rate increases at both WPS and UPPCO, effective January 1, 2010. These rate increases were necessary, in part, for recovery of higher operating expenses (as discussed below).
- An approximate \$14 million increase in revenues primarily due to a 9.1% increase in sales volumes to large commercial and industrial customers at WPS related to changes in business operations, which Integrys Energy Group attributes mainly to improved economic conditions in WPS's service territory period-over-period.
- An approximate \$11 million increase due to a 4.2% increase in sales volumes to residential customers at WPS primarily related to warmer period-over-period weather during the cooling season as evidenced by the increase in cooling degree days.
- An approximate \$11 million increase in opportunity sales at WPS, made possible by the availability of low-cost energy from Weston 4.
- These increases in regulated electric utility segment revenues were partially offset by an approximate \$10 million decrease in revenues from wholesale customers at WPS primarily due to a decrease in fuel costs. The decrease in fuel costs caused a decrease in per-unit revenues because commodity costs are passed directly through to these customers in rates.

Margins

Regulated electric utility segment margins increased \$47.5 million period-over-period, driven by:

- An approximate \$19 million increase in margins related to fuel and purchased power costs at WPS, primarily driven by lower fuel and purchased power costs incurred during the first nine months of 2010 (as compared with authorized fuel and purchased power cost recovery rates).
- An approximate \$16 million combined positive impact of retail electric rate increases at both WPS and UPPCO, effective January 1, 2010.
- An approximate \$8 million increase in margins due to a 4.2% increase in sales volumes to residential customers at WPS, primarily related to warmer period-over-period weather during the cooling season as evidenced by the increase in cooling degree days. WPS reached the annual \$14.0 million electric decoupling cap in the second quarter of 2010 and 2009 and remained over the cap through the end of the third quarter in both years.
- An approximate \$6 million increase in margins primarily due to a 9.1% increase in sales volumes to large commercial and industrial customers at WPS related to changes in business operations, which Integrys Energy Group attributes mainly to improved economic conditions in WPS's service territory period-over-period.

Operating Income

Operating income at the regulated electric utility segment increased \$22.0 million period-over-period, driven by the \$47.5 million increase in electric margins, partially offset by a \$25.5 million increase in operating expenses.

The increase in operating expenses was the result of:

- A \$10.6 million increase in electric transmission expense.
- A \$9.4 million increase in customer assistance expense related to payments made to the Focus on Energy program, which helps residents and businesses install cost-effective, energy efficient, and renewable energy products.
- An \$8.4 million increase in employee benefit costs, primarily related to an increase in pension and other postretirement benefit expenses, driven by the amortization of negative investment returns on plan assets from prior years.
- A \$4.2 million increase in depreciation and amortization expense at WPS, primarily related to the Crane Creek Wind Farm being placed in service for accounting purposes in December 2009.
- A \$3.8 million increase in stock-based compensation expense. See Note 17, "*Stock-Based Compensation*," for more information.
- These increases in regulated electric utility operating expenses were partially offset by:
 - A \$4.8 million decrease in electric maintenance expense at WPS, primarily related to a greater number of planned outages at its generation plants during the nine months ended September 30, 2009, compared with the same period in 2010.
 - A \$4.8 million decrease in labor costs, driven by the reduction in workforce and company-wide furloughs implemented as part of previously announced cost management efforts.

Other Expense

Other expense at the regulated electric utilities increased \$4.2 million, driven by a \$4.2 million decrease in AFUDC related to the Crane Creek Wind Farm.

Electric Transmission Investment Segment Operations

Third Quarter 2010 Compared with Third Quarter 2009

Miscellaneous Income

Miscellaneous income at the electric transmission investment segment decreased \$0.1 million during the third quarter of 2010 compared with the same quarter in 2009, due to a decrease in income from Integrys Energy Group's approximate 34% ownership interest in ATC. ATC's continuing investment in transmission equipment and facilities resulted in increased returns, which were more than offset by an increase in expenses not recoverable in rates.

Nine Months 2010 Compared with Nine Months 2009

Miscellaneous Income

Miscellaneous income at the electric transmission investment segment increased \$2.2 million during the nine months ended September 30, 2010, compared with the same period in 2009, due to an increase in income from Integrys Energy Group's approximate 34% ownership interest in ATC. The increase in income was driven by returns earned by ATC on investments in transmission equipment and facilities for improved reliability.

Integrys Energy Services' Operations

Integrys Energy Services is a diversified nonregulated retail energy supply and services company serving residential, commercial, and industrial customers. In addition, Integrys Energy Services invests in energy assets with renewable attributes.

Integrys Energy Services Segment Results of Operations

<i>(Millions, except natural gas sales volumes)</i>	Three Months		Change in 2010 over 2009	Nine Months		Change in 2010 over 2009
	Ended September 30 2010	2009		Ended September 30 2010	2009	
Revenues	\$396.3	\$751.2	(47.2)%	\$1,442.1	\$3,347.8	(56.9)%
Cost of fuel, natural gas, and purchased power	336.7	660.4	(49.0)%	1,289.2	3,136.2	(58.9)%
Margins	59.6	90.8	(34.4)%	152.9	211.6	(27.7)%
Margin Detail						
Realized retail electric margins	20.7	20.0	3.5 %	60.6 ⁽¹⁾	66.4	(8.7)%
Realized wholesale electric margins	(3.4) ⁽²⁾	(1.1)	209.1 %	(5.0) ⁽³⁾	25.9	N/A
Fair value adjustments	5.3	50.7	(89.5)%	9.7	14.9	(34.9)%
Energy assets	10.2	10.9	(6.4)%	26.5	27.8	(4.7)%
Electric and other margins	32.8	80.5	(59.3)%	91.8	135.0	(32.0)%
Realized retail natural gas margins	3.2	4.6	(30.4)%	36.0	51.9	(30.6)%
Realized wholesale natural gas margins	(0.4)	10.4	N/A	(4.4)	35.6	N/A
Lower-of-cost-or-market inventory adjustments	0.4	69.0	(99.4)%	6.4	134.0	(95.2)%
Fair value adjustments	23.6	(73.7)	N/A	23.1	(144.9)	N/A
Natural gas margins	26.8	10.3	160.2 %	61.1	76.6	(20.2)%
Operating and maintenance expense	26.6	37.2	(28.5)%	85.4	145.0	(41.1)%
Impairment losses on property, plant, and equipment	43.2	-	N/A	43.2	0.7	6,071.4 %
Restructuring expense	(0.1)	2.4	N/A	9.1	21.5	(57.7)%
Net (gain) loss on Integrys Energy Services' dispositions related to strategy change	(0.2)	0.2	N/A	14.6	0.2	7,200.0 %
Depreciation and amortization	4.8	4.9	(2.0)%	14.0	14.7	(4.8)%
Taxes other than income taxes	1.3	1.7	(23.5)%	5.1	6.1	(16.4)%
Operating income (expense)	(16.0)	44.4	N/A	(18.5)	23.4	N/A
Miscellaneous income	5.1	3.2	59.4 %	8.0	5.2	53.8 %
Interest expense	(1.0)	(4.2)	(76.2)%	(5.8)	(9.9)	(41.4)%
Other income (expense)	4.1	(1.0)	N/A	2.2	(4.7)	N/A
Income (loss) before taxes	\$ (11.9)	\$ 43.4	N/A	\$ (16.3)	\$ 18.7	N/A
Physically settled volumes						
Retail electric sales volumes in kwh	3,373.5	3,967.0	(15.0)%	9,716.6	11,683.6	(16.8)%
Wholesale electric sales volumes in kwh	298.4	925.3	(67.8)%	1,119.7	3,096.2	(63.8)%
Retail natural gas sales volumes in bcf	21.6	45.6	(52.6)%	95.8	197.5	(51.5)%
Wholesale natural gas sales volumes in bcf	1.5	95.8	(98.4)%	27.2	357.5	(92.4)%

kwh – kilowatt-hours
bcf – billion cubic feet

⁽¹⁾ This amount includes negative margin of \$1.4 million related to the settlement of supply contracts in connection with Integrys Energy Services' strategy change.

⁽²⁾ This amount includes negative margin of \$2.8 million related to the settlement of supply contracts in connection with Integrys Energy Services' strategy change.

⁽³⁾ This amount includes negative margin of \$6.6 million related to the settlement of supply contracts in connection with Integrys Energy Services' strategy change.

Third Quarter 2010 Compared with Third Quarter 2009

Revenues

Revenues decreased \$354.9 million quarter-over-quarter, as a result of Integrys Energy Group's decision to reposition Integrys Energy Services to focus on selected electric and natural gas retail markets in the United States and investments in energy assets with renewable attributes. See Note 5, "*Dispositions*," for a discussion of the dispositions completed in connection with Integrys Energy Services' strategy change. Also contributing to the decrease in revenues were lower energy prices, as the average market price of natural gas and electricity decreased approximately 11% and 3% quarter-over-quarter, respectively.

Margins

Integrys Energy Services uses derivative and nonderivative financial instruments to economically hedge risks associated with physical transactions. Because many of the derivative instruments utilized in these transactions may not qualify, or are not designated, as hedges under GAAP derivative accounting rules, fluctuations in the fair value of these instruments due to changing commodity prices are recorded as unrealized gains or losses within margins. Nonderivative instruments have no impact on margins until settlement.

Integrys Energy Services' margins decreased \$31.2 million quarter-over-quarter. The significant items contributing to the change in margins were as follows:

Electric and Other Margins

Realized retail electric margins

Realized retail electric margins increased \$0.7 million quarter-over-quarter due to a \$5.7 million quarter-over-quarter increase from the markets that Integrys Energy Services will retain as part of its revised strategy, partially offset by a \$5.0 million decrease in realized retail electric margin from markets that are not part of Integrys Energy Service's revised strategy.

The primary drivers for the change were as follows:

- A \$4.5 million increase in the Illinois market, primarily driven by a change in pricing strategy that was implemented to reflect a higher cost of capital.
- Partially offsetting this increase was a \$3.8 million decrease in the Texas market. The decrease was due to the sale of Integrys Energy Services of Texas, LP, which was completed in June 2010. See Note 5, "*Dispositions*," for a discussion of this sale.

Realized wholesale electric margins

Wholesale transactions and structured origination activity were significantly scaled back in conjunction with Integrys Energy Services' sale of substantially all of its United States wholesale electric marketing and trading business, which was completed in February 2010. The majority of the remaining realized wholesale electric activity at Integrys Energy Services is related to a single contract that will be fully settled by the end of 2010. See Note 5, "*Dispositions*," for more information on Integrys Energy Services' sale of its United States wholesale electric marketing and trading business.

Fair value adjustments

Fair value adjustments required under derivative accounting rule relate to electric supply contracts used to economically hedge risks associated with electric sales contracts.