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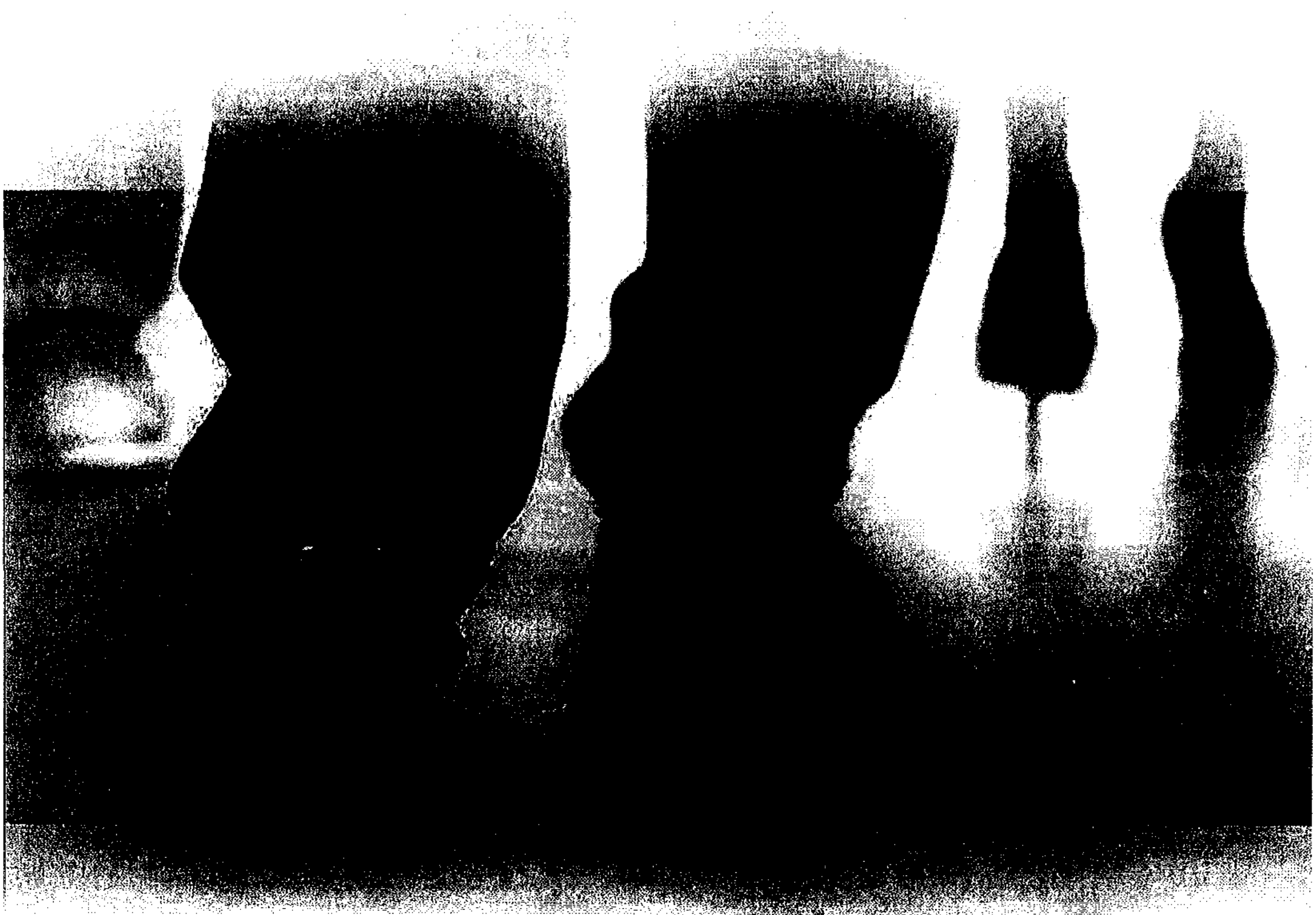
2010 Annual Report



integrys®

## NOTE 19—COMMON EQUITY

Integrys Energy Group's reconciliation of shares outstanding at December 31, 2010, and 2009, was as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Shares | Average Cost | Shares | Average Cost |
| Common stock issued | [redacted] | [redacted] | 76,418,843 | |
| Less: | [redacted] | [redacted] | | |
| Deferred compensation rabbi trust | [redacted] | [redacted] | 402,839 | $42.58 [1] |
| Restricted stock | [redacted] | [redacted] | 35,861 | $55.33 [2] |
| Total shares outstanding | [redacted] | [redacted] | 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. These stock issuances increased equity $55.8 million in 2010. From January 1, 2010, to February 10, 2010, and during 2009 and 2008, Integrys Energy Group purchased shares of its common stock on the open market to meet the requirements of these plans.

| Integrys Energy Group's common stock shares | |
|---|---|
| Balance at December 31, 2007 | 76,434,095 |
| Restricted stock shares cancelled | (4,058) |
| Balance at December 31, 2008 | 76,430,037 |
| Restricted stock shares cancelled | (11,194) |
| Balance at December 31, 2009 | 76,418,843 |
| Shares issued: | [redacted] |
| Stock Investment Plan | [redacted] |
| Stock-based compensation | [redacted] |
| Rabbi trust shares | [redacted] |
| Restricted stock shares cancelled | [redacted] |
| **Balance at December 31, 2010** | [redacted] |

### 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 2010 excluded 1.4 million out-of-the-money stock options that had an anti-dilutive effect. The effects of an insignificant number of in-the-money securities were not included in the computation for 2009, because there was a net loss during the period, which would have caused the impact to be anti-dilutive. The 2009 calculation of diluted earnings per share also excluded 2.7 million out-of-the-money stock options that had an anti-dilutive effect. The calculation of diluted earnings per share for 2008 excluded 2.2 million out-of-the-money stock options that had an anti-dilutive effect.

The following table reconciles the computation of basic and diluted earnings (loss) per share:

| (Millions, except per share amounts) | 2010 | 2009 | 2008 |
|---|---|---|---|
| **Numerator:** | | | |
| Net income (loss) from continuing operations | [illegible] | $(70.3) | $114.8 |
| Discontinued operations, net of tax | [illegible] | 2.8 | 4.7 |
| Preferred stock dividends of subsidiary | [illegible] | (3.1) | (3.1) |
| Noncontrolling interest in subsidiaries | [illegible] | 1.0 | 0.1 |
| Net income (loss) attributed to common shareholders | [illegible] | $(69.6) | $116.5 |
| **Denominator:** | | | |
| Average shares of common stock – basic | [illegible] | 76.8 | 76.7 |
| Effect of dilutive securities | | | |
| Stock-based compensation | [illegible] | – | 0.3 |
| Average shares of common stock – diluted | [illegible] | 76.8 | 77.0 |
| Earnings (loss) per common share | | | |
| Basic | [illegible] | $(0.91) | $1.52 |
| Diluted | [illegible] | (0.91) | 1.51 |
| Dividends per common share declared | [illegible] | $2.72 | $2.68 |

## Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of tax, at December 31, 2010, and 2009, were:

| (Millions) | 2010 | 2009 |
|---|---|---|
| Cash flow hedges [1] | [illegible] | $(24.9) |
| Unrecognized pension and other postretirement benefit costs [2] | [illegible] | (21.5) |
| Foreign currency translation | [illegible] | 2.4 |
| Total accumulated other comprehensive loss | [illegible] | $(44.0) |

[1] *Includes tax benefits of $13.9 million and $18.6 million at December 31, 2010, and 2009, respectively.*
[2] *Includes tax benefits of $15.8 million and $13.8 million at December 31, 2010, and 2009, respectively.*

## NOTE 20—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 shares, plus any shares remaining or forfeited under prior plans, and no more than 900,000 shares of stock, plus shares remaining or forfeited under prior plans, can be granted as full value shares in the form of 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 awards. At December 31, 2010, stock options, performance stock rights, and restricted shares and restricted share units 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 and recorded the cumulative effect in earnings in the third quarter of 2010.

## Stock Options

Under the provisions of the 2010 Omnibus Plan, no single employee who is the chief executive officer of Integrys Energy Group or any of the other three highest compensated officers of Integrys Energy Group and its subsidiaries can be granted options for more than 1,000,000 shares during any calendar year. No stock options will have a term longer than ten years. The exercise price of each stock option is equal to the fair market value of the stock on the date the stock option is granted. Generally, one-fourth of the stock options granted vest and become exercisable each year on the anniversary of the grant date.

The fair values of stock option awards granted were estimated using a binomial lattice model. The expected term of option awards is calculated based on historical exercise behavior and represents the period of time that options are expected to be outstanding. The risk-free interest rate is based on the United States Treasury yield curve. The expected dividend yield incorporates the current and historical dividend rate. Integrys Energy Group's expected stock price volatility was estimated using its 10-year historical volatility.

The following table shows the weighted-average fair values per stock option along with the assumptions incorporated into the valuation models:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Weighted-average fair value per option | [illegible] | $3.83 | $4.52 |
| Expected term | 6 years | 8 - 9 years | 7 years |
| Risk-free interest rate | 2.38% | 2.50% - 2.78% | 3.40% |
| Expected dividend yield | [illegible] | 5.50% | 5.00% |
| Expected volatility | 25% | 19% | 17% |

Compensation cost recognized for stock options during 2010, 2009, and 2008, was $2.3 million, $2.0 million, and $2.6 million, respectively. Compensation cost capitalized during these same years was not significant. As of December 31, 2010, $1.3 million of compensation cost related to unvested and outstanding stock options was expected to be recognized over a weighted-average period of 2.6 years.

Cash received from option exercises was $18.8 million during 2010. Cash received from option exercises during 2009 was not significant and was $3.3 million during 2008. The tax benefit realized from these option exercises was not significant in 2010, 2009, and 2008.

A summary of stock option activity for 2010, and information related to outstanding and exercisable stock options at December 31, 2010, is presented below:

| | Stock Options | Weighted-Average Exercise Price Per Share | Weighted-Average Remaining Contractual Life *(in Years)* | Aggregate Intrinsic Value *(Millions)* |
|---|---|---|---|---|
| Outstanding at December 31, 2009 | 3,133,286 | $47.06 | | |
| Granted | 554,092 | 41.58 | | |
| Exercised | (486,624) | 38.56 | | $2.9 |
| Forfeited | (110,808) | 41.58 | | 0.8 |
| Expired | (97,247) | 48.55 | | 0.3 |
| **Outstanding at December 31, 2010** | 2,992,699 | $47.59 | 6.27 | $8.0 |
| **Exercisable at December 31, 2010** | 1,852,573 | $49.75 | 5.09 | $2.2 |

The aggregate intrinsic value for outstanding and exercisable options in the above table represents the total pre-tax intrinsic value that would have been received by the option holders had they all exercised their options at December 31, 2010. This is calculated as the difference between Integrys Energy Group's closing stock price on December 31, 2010, and the option exercise price, multiplied by the number of in-the-money stock options. The intrinsic value of options exercised was not significant during 2009 and 2008.

## Performance Stock Rights

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

Performance stock rights are accounted for as liability awards and are remeasured each reporting period throughout the requisite service period.

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

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Risk-free interest rate | 0.21% - 0.56% | 1.38% | 2.18% |
| Expected dividend yield | 5.34% | 5.50% | 5.50% |
| Expected volatility | 20% - 34% | 26% | 17% |

Compensation cost recognized for performance stock rights for 2010, 2009, and 2008 was $[illegible] million, $4.4 million, and $6.2 million, respectively. Compensation cost capitalized during these same years was not significant. As of December 31, 2010, $[illegible] million of compensation cost related to unvested and outstanding performance stock rights was expected (based on the value of these awards at the reporting date) to be recognized over a weighted-average period of [illegible] years.

A summary of the activity related to performance stock rights for the year ended December 31, 2010, is presented below:

| | Performance Stock Rights |
|---|---|
| Outstanding at December 31, 2009 | 301,090 |
| Granted | 150,481 |
| Distributed | (45,847) |
| Adjustment for final payout | (26,009) |
| Forfeited | (38,077) |
| Outstanding at December 31, 2010 | 341,638 |

## Restricted Shares and Restricted Share Units

A portion of the long-term incentive is awarded in the form of restricted shares and restricted share units. Most of these awards have a four-year vesting period, with 25% of each award vesting on each anniversary of the grant date. During the vesting period, restricted share recipients have voting rights and are entitled to dividends in the same manner as other common shareholders, whereas restricted share unit recipients receive dividend credits and do not have voting rights. Restricted shares and restricted share units are accounted for as liability awards and are remeasured each period based on Integrys Energy Group's closing stock price at the reporting date. Compensation cost recognized for these awards was $10.[illegible] million, $9.9 million, and $4.2 million during 2010, 2009, and 2008, respectively. Compensation cost capitalized during these same years was not significant. As of December 31, 2010, $11.7 million of compensation cost related to these awards was expected (based on the value of these awards at the reporting date) to be recognized over a weighted-average period of 2.5 years.

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

| | Restricted Shares and Restricted Share Unit Awards |
|---|---|
| Outstanding at December 31, 2009 | 346,858 |
| Granted | 210,922 |
| Vested | (106,153) |
| Forfeited | (46,265) |
| Outstanding at December 31, 2010 | 405,362 |

# NOTE 21—VARIABLE INTEREST ENTITIES

Effective January 1, 2010, Integrys Energy Group implemented Statement of Financial Accounting Standards (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 December 31, 2010, and December 31, 2009, Integrys Energy Group had approximately 5[illegible] 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 December 31, 2010, the assets and liabilities on the 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, LLC (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 the remaining 50% ownership interest in LGS from LGS Development, L.P. and became the sole owner.

## COMMON STOCK

The New York Stock Exchange is the principal market for Integrys Energy Group, Inc. common stock, which trades under the ticker symbol of TEG. On December 31, 2010, we had 77,350,079 shares of common stock outstanding, which were owned by 30,352 holders of record.

## DIVIDENDS

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

**Year Ended December 31** ***(By Quarter)***

| | [illegible] | Price Range High | Price Range Low |
|---|---|---|---|
| [illegible] | [illegible] | [illegible] | [illegible] |

## STOCK INVESTMENT PLAN

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

The Stock Investment Plan also provides you with options for reinvesting your dividends and making optional cash purchases of common stock directly through the Plan without paying brokerage commissions, fees, or service charges. Optional cash payments of not less than $25 per payment may be made subject to a maximum of $100,000 per calendar year. An automatic investment option allows you to authorize the deduction of payments from your checking or savings account automatically once each month, on the third day of the month, by electronic means for investment in the Plan. Cash for investment must be received by the 3rd or 18th day of the month. Investment generally commences on or about the 5th or 20th day of the month, or as soon thereafter as practicable.

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

Participation in the Stock Investment Plan is being offered only by means of a prospectus. If you would like a copy of the Stock Investment Plan prospectus, you may use the American Stock Transfer & Trust Company, LLC website at www.amstock.com, call American Stock Transfer & Trust Company, LLC at 800-236-1551, contact us by sending an e-mail to investor@integrysgroup.com, or order or download the prospectus and enrollment forms from our website at www.integrysgroup.com under "Investor."

## STOCK TRANSFER AGENT AND REGISTRAR

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

Questions about transferring stock, lost certificates, or changing the name in which certificates are registered should be directed to American Stock Transfer & Trust Company, LLC at the addresses or telephone numbers listed on the back cover. If your address changes, write to American Stock Transfer & Trust Company, LLC at the address on the back of this report or use their website at www.amstock.com.

## AVAILABILITY OF INFORMATION

Company financial information is available on our website at www.integrysgroup.com under "Investor."

You may obtain, without charge, a copy of our 2010 Form 10-K, without exhibits, as filed with the Securities and Exchange Commission, by contacting the Corporate Secretary at the corporate office mailing address listed on the back cover, or by using our website.

## INTERNET

Visit our website at www.integrysgroup.com to find a wealth of information about our company and its subsidiaries. The site will give you instant access to Annual Reports, SEC filings, proxy statements, financial news, presentations, news releases, corporate governance information, career opportunities, and much more. You may also download a copy of the prospectus for the Stock Investment Plan and the associated forms for participation in the Plan.

## ANNUAL SHAREHOLDERS' MEETING

Our Annual Shareholders' Meeting will be held on Wednesday, May 11, 2011, at 10 a.m. Central daylight time at the Weidner Center, on the campus of the University of Wisconsin – Green Bay, 2420 Nicolet Drive, Green Bay, Wisconsin. Proxy statements for our May 11, 2011, Annual Shareholders' Meeting were mailed to shareholders of record on April 1, 2011.

## ANNUAL REPORT

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

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

## CORPORATE GOVERNANCE INFORMATION

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

## CERTIFICATIONS

We have filed as exhibits to our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, the certifications of our Chief Executive Officer and Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act. We also submitted to the New York Stock Exchange during 2010 the Annual CEO Certification required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.