ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

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

Strategic Overview

Our goal is to create long-term value for shareholders and customers through growth in our core regulated businesses. We also have a nonregulated energy services business segment that is focused on growth within a controlled risk profile.

The essential components of our business strategy are:

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

- An accelerated annual investment in natural gas distribution facilities (primarily replacement of cast iron mains) at PGL.
- WPS's continued investment in environmental projects to improve air quality and meet the requirements set by environmental regulators. Capital projects to construct and/or upgrade equipment to meet or exceed required environmental standards are planned each year.
- Our approximate 34% ownership interest in ATC, a transmission company that had over $3.0 billion of transmission assets at December 31, 2011. ATC plans to invest approximately $3.8 billion to $4.4 billion during the next ten years. Although ATC's equity requirements to fund its capital investments will primarily be met by earnings reinvestment, we plan to continue to fund our share of the equity portion of future ATC growth as necessary.

For more detailed information on our capital expenditure program, see "*Liquidity and Capital Resources, Capital Requirements*."

Continuing Emphasis on Safe, Reliable, Competitively Priced, and Environmentally Sound Energy and Related Services – Our mission is to provide customers with the best value in energy and related services. Ensuring continued reliability for our customers, we strive to effectively operate a mixed portfolio of generation assets and invest in new generation and natural gas distribution assets, while maintaining or exceeding environmental standards. This allows us to provide a safe, reliable, value-priced service to our customers. We concentrate our efforts on improving and operating efficiently in order to reduce costs and maintain a low risk profile. We actively evaluate opportunities for adding more renewable generation to provide additional environmentally sound energy to our portfolio. Our recent entry into the compressed natural gas fueling marketplace, while not currently significant, is complementary to our existing businesses and is consistent with our mission.

Operating a Nonregulated Energy Services Business Segment with a Controlled Risk and Capital Profile – Through our nonregulated Integrys Energy Services subsidiary, we provide retail natural gas and electric products to end-use customers in the northeast quadrant of the United States. In addition, Integrys Energy Services continues to develop, acquire, own and operate renewable energy projects, primarily distributed solar generation, in the United States. We have repositioned this subsidiary from a focus on significant growth in wholesale and retail electric markets across the United States and Canada, to a focus on operating within select retail electric and natural gas markets in our current market footprint where we have experience and believe we will have the most success growing our recurring customer based business. The current strategy is intended to result in more dependable cash and earnings contributions with a controlled risk and capital profile.

Integrating Resources to Provide Operational Excellence – We are committed to integrating resources of all our businesses, while meeting all applicable legal and regulatory requirements. This will provide the best value to customers and shareholders by leveraging the individual capabilities and expertise of each business and lowering costs. "Operational Excellence" initiatives are implemented to encourage top performance in the areas of project management, process improvement, contract administration, and compliance in order to reduce costs and manage projects and activities within appropriate budgets, schedules, and regulations.

Placing Strong Emphasis on Asset and Risk Management – Our asset management strategy calls for the continuous assessment of existing assets, the acquisition of assets, and contractual commitments to obtain resources that complement our existing business and strategy. The goal is to provide the most efficient use of resources while maximizing return and maintaining an acceptable risk profile. This strategy focuses on acquiring assets consistent with strategic plans and disposing of assets, including property, plant, and equipment and entire business units, that are no longer strategic to ongoing operations, are not performing as intended, or have an unacceptable risk profile. We maintain a portfolio approach to risk and earnings.

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

RESULTS OF OPERATIONS

Earnings Summary

	Year Ended December 31			Change in	Change in
(Millions, except per share amounts)	2011	2010	2009	2011 Over 2010	2010 Over 2009
Natural gas utility operations	**$103.3**	$ 84.0	$(172.1)	23.0 %	N/A
Electric utility operations	**100.5**	109.8	88.9	(8.5)%	23.5 %
Electric transmission investment	**47.8**	46.2	45.5	3.5 %	1.5 %
Integrys Energy Services operations	**(6.1)**	3.3	3.8	N/A	(13.2)%
Holding company and other operations	**(18.1)**	(22.4)	(35.7)	(19.2)%	(37.3)%
Net income (loss) attributed to common shareholders	**$227.4**	$220.9	$ (69.6)	2.9 %	N/A
Basic earnings (loss) per share	**$2.89**	$2.85	$(0.91)	1.4 %	N/A
Diluted earnings (loss) per share	**$2.87**	$2.83	$(0.91)	1.4 %	N/A
Average shares of common stock					
Basic	**78.6**	77.5	76.8	1.4 %	0.9 %
Diluted	**79.1**	78.0	76.8	1.4 %	1.6 %

2011 Compared with 2010

Our earnings for 2011 were $227.4 million, compared with $220.9 million for 2010. The $6.5 million increase in earnings was driven by:

- The $31.8 million after-tax decreases in impairment losses recorded on generation plants and losses on dispositions at Integrys Energy Services.
- An additional $20.3 million after-tax net decrease in operating expenses across all segments, driven by a decrease in employee benefit costs and lower depreciation and amortization expense.
- The $15.0 million positive year-over-year impact of tax adjustments recorded in 2011 and 2010 in connection with the federal health care reform.
- A $14.4 million after-tax increase in Integrys Energy Services' realized margins.

These increases were partially offset by:

- A $66.1 million after-tax decrease in Integrys Energy Services' margins from non-cash derivative and inventory fair value adjustments.
- An $8.4 million after-tax decrease in electric utility margins, mainly caused by differences in WPS's 2011 electric rate order compared with the previous rate order.

2010 Compared with 2009

We recognized net income attributed to common shareholders of $220.9 million in 2010 compared with a net loss attributed to common shareholders of $69.6 million in 2009. The primary driver of the $290.5 million increase in earnings was an after-tax noncash goodwill impairment loss of $248.8 million recorded in 2009, compared with no goodwill impairment losses in 2010. Other factors contributing to the increase were the combined approximate $69 million after-tax positive impact on margins of electric and natural gas distribution rate increases effective in 2010, and a $22.5 million after-tax reduction in restructuring expenses year over year. These increases in earnings were partially offset by after-tax impairment charges of $25.9 million in 2010 related to three natural gas-fired generation plants at Integrys Energy Services.

Regulated Natural Gas Utility Segment Operations

(Millions, except degree days)	Year Ended December 31 2011	2010	2009	Change in 2011 Over 2010	Change in 2010 Over 2009
Revenues	**$1,998.0**	$2,057.2	$2,237.5	(2.9)%	(8.1)%
Purchased natural gas costs	**1,101.4**	1,152.0	1,382.0	(4.4)%	(16.6)%
Margins	**896.6**	905.2	855.5	(1.0)%	5.8 %
Operating and maintenance expense	**523.6**	542.1	532.6	(3.4)%	1.8 %
Goodwill impairment loss	-	-	291.1	N/A	(100.0)%
Restructuring expense	-	(0.2)	6.9	(100.0)%	N/A
Depreciation and amortization expense	**126.1**	130.9	106.1	(3.7)%	23.4 %
Taxes other than income taxes	**35.6**	34.4	33.4	3.5 %	3.0 %
Operating income (loss)	**211.3**	198.0	(114.6)	6.7 %	N/A
Miscellaneous income	**2.2**	1.6	3.1	37.5 %	(48.4)%
Interest expense	**(48.4)**	(49.7)	(52.2)	(2.6)%	(4.8)%
Other expense	**(46.2)**	(48.1)	(49.1)	(4.0)%	(2.0)%
Income (loss) before taxes	**$ 165.1**	$ 149.9	$ (163.7)	10.1 %	N/A
Retail throughput in therms					
Residential	**1,541.5**	1,496.4	1,602.8	3.0 %	(6.6)%
Commercial and industrial	**469.5**	455.5	501.4	3.1 %	(9.2)%
Other	**61.3**	53.7	60.8	14.2 %	(11.7)%
Total retail throughput in therms	**2,072.3**	2,005.6	2,165.0	3.3 %	(7.4)%
Transport throughput in therms					
Residential	**237.4**	224.4	237.7	5.8 %	(5.6)%
Commercial and industrial	**1,559.7**	1,504.0	1,403.9	3.7 %	7.1 %
Total transport throughput in therms	**1,797.1**	1,728.4	1,641.6	4.0 %	5.3 %
Total throughput in therms	**3,869.4**	3,734.0	3,806.6	3.6 %	(1.9)%
Weather					
Average heating degree days	**6,675**	6,440	7,061	3.6 %	(8.8)%

2011 Compared with 2010

Margins

Natural gas utility margins are defined as natural gas utility operating revenues less purchased natural gas costs. Management believes that natural gas utility margins provide a more meaningful basis for evaluating natural gas utility operations than natural gas revenues since we pass through prudently incurred natural gas commodity costs to our customers in current rates. There was an approximate 7% decrease in the average per-unit cost of natural gas sold during 2011, which had no impact on margins.

Regulated natural gas utility segment margins decreased $8.6 million. The decrease in margins was driven by the approximate $19 million negative year-over-year impact at PGL and NSG of higher regulatory refunds and lower regulatory recoveries that are offset by equal decreases in operating and maintenance expense, resulting in no impact on earnings. We refunded approximately $13 million more to customers under bad debt riders in 2011. We also recovered approximately $6 million less for environmental cleanup costs at our former manufactured gas plant sites in 2011. See Note 26, "*Regulatory Environment*," for more information on the PGL and NSG bad debt riders and Note 16, "*Commitment and Contingencies*," for more information on our manufactured gas plant sites.

The decrease in margins was partially offset by:

- An approximate $4 million net increase in margins as a result of a 3.6% increase in volumes sold.
  - Higher sales volumes excluding the impact of weather resulted in approximately $17 million of additional margins. We attribute this increase to a combination of higher use per customer, higher average customer counts, and improved economic conditions for certain customers.
  - Colder weather during 2011, as shown by the 3.6% increase in heating degree days, drove an approximate $6 million increase in margins.
  - Partially offsetting these increases was an approximate $19 million decrease due to decoupling mechanisms at certain natural gas utilities. Although decoupling was implemented to minimize the impact of changes in sales volumes, it does not cover all jurisdictions or customers. During 2011, decoupling lessened the positive impact from some of the increased sales volumes through higher future customer refunds. During 2010, decoupling lessened the negative impact from some of the decreased sales volumes through higher future customer recoveries.
- An approximate $4 million net increase in margins from rate orders. See Note 26, "*Regulatory Environment,*" for more information on these rate orders.
  - MERC's conservation improvement program (CIP) rate increase, effective November 1, 2010, and its interim natural gas distribution rate increase, effective February 1, 2011, had a combined approximate $13 million positive impact on margin. The CIP margins of approximately $7 million did not impact earnings as they were offset by an increase in operating and maintenance expense.
  - The rate increases at PGL and NSG, effective January 28, 2010, and other impacts of rate design, had an approximate $7 million net positive impact on margins.
  - The rate decrease at WPS, effective January 14, 2011, resulted in an approximate $16 million negative impact on margins.
- An approximate $2 million increase in margins due to a year-over-year positive impact from the 2010 amortization of a regulatory asset at WPS related to energy efficiency legislation implemented in a prior year.
- An approximate $2 million increase in margins due to a rider approved through September 30, 2011 for recovery of AMRP costs at PGL. See Note 26, "*Regulatory Environment,*" for more information on this rider.

<u>*Operating Income*</u>

Operating income at the regulated natural gas utility segment increased $13.3 million. This increase was primarily driven by a $21.9 million decrease in operating expenses, partially offset by the $8.6 million decrease in margins discussed above.

The decrease in operating expenses primarily related to:

- An approximate $19 million decrease due to higher amortization of regulatory liabilities related to bad debt riders and lower amortization of regulatory assets related to environmental cleanup costs for manufactured gas plant sites, all at PGL and NSG. Margins decreased by an equal amount, resulting in no impact on earnings.
- A $4.8 million decrease in depreciation and amortization expense. WPS received approval for lower depreciation rates from the PSCW, effective January 1, 2011. The decrease also reflects the impact of a $2.5 million write-off of certain MGU assets in 2010, which is currently pending appeal before the Michigan Court of Appeals.
- A $7.8 million decrease in employee benefits expense, partially driven by lower employee health care costs.
- A $3.6 million decrease in customer accounts expense resulting from lower customer call volumes and a decrease in labor associated with fewer disconnections.
- A $2.6 million decrease in asset usage charges from IBS related to retirement of certain computer hardware.

- These decreases were partially offset by:
  - A $10.0 million increase in natural gas distribution costs. The increase was partially due to additional labor related to distribution operations activities and additional consulting costs associated with a work asset management system and the AMRP. Transportation costs, building maintenance, meter maintenance projects, and other miscellaneous distribution costs also contributed to the increase.
  - A $5.0 million increase in expenses related to energy conservation and efficiency programs. This net increase includes expenses related to the CIP that were recovered through the MERC rate increase discussed in margins above.

Other Expense

Other expense decreased $1.9 million, driven by a decrease in interest expense on long-term debt. PGL refinanced some of its long-term debt at lower interest rates in the second half of 2010. In addition, WPS did not replace certain senior notes that matured in the third quarter of 2011.

2010 Compared with 2009

Margins

Natural gas utility margins are defined as natural gas utility operating revenues less purchased natural gas costs. Management believes that natural gas utility margins provide a more meaningful basis for evaluating natural gas utility operations than natural gas revenues since we pass through prudently incurred natural gas commodity costs to our customers in current rates. There was an approximate 9% decrease in the average per-unit cost of natural gas sold during 2010, which had no impact on margins.

Regulated natural gas utility segment margins increased $49.7 million, driven by the approximate $96 million positive impact of rate increases. These rate increases were necessary, in part, to recover higher operating expenses (as discussed below). See Note 26, "*Regulatory Environment,*" for more information on these rate increases. The rate increases at PGL and NSG had an approximate $77 million positive impact on margins. The rate increase at WPS and MGU had an approximate $13 million and $3 million positive impact on margins, respectively. A rate increase at MERC related to its CIP had an approximate $3 million positive impact on margins. CIP margins are offset by a corresponding increase in operating and maintenance expense and, therefore, had no impact on earnings.

This increase in margins was partially offset by:

- An approximate $28 million decrease in margins resulting from the 1.9% lower volumes sold, related to:
  - An approximate $19 million decrease related to warmer weather during 2010, as evidenced by the 8.8% decrease in heating degree days.
  - An approximate $19 million decrease related to lower sales volumes excluding the impact of weather. Residential customer sales volumes decreased, which we attribute to energy conservation, efficiency efforts, and general economic conditions. This decrease was partially offset by a net increase in commercial and industrial sales volumes for both retail and transportation customers, driven by certain transportation customers of MERC and MGU.
  - Partially offsetting these decreases was the approximate $10 million increase in 2010 due to decoupling mechanisms in place at certain of our regulated natural gas utilities. Under decoupling, certain of our regulated natural gas utilities are allowed to defer the difference between the actual and rate case authorized delivery charge components of margin from certain customers and adjust future rates in accordance with rules applicable to each jurisdiction. 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 in the first quarter of 2010 but was not reached in 2009.
- An approximate $18 million net decrease in margins driven by lower recovery of environmental cleanup expenditures at our former manufactured gas plant sites, partially offset by an increase in margins related to recoveries received under the PGL and NSG bad debt riders. These amounts were offset by an equal net decrease in operating and maintenance expense resulting from lower net amortization of the related regulatory assets and, therefore, had no impact on earnings. Recoveries under these riders represent net billings to customers of the excess or deficiency of actual 2008 and 2009 bad debt expense over bad debt expense reflected in utility rates during those same periods. See Note 26, "*Regulatory Environment,*" for more information on the PGL and NSG bad debt riders.

Operating Income (Loss)

Operating income at the regulated natural gas utility segment increased $312.6 million. This increase was primarily driven by the positive impact of a $291.1 million noncash goodwill impairment loss that was recorded in the first quarter of 2009. Also contributing to the increase was the $49.7 million increase in the natural gas margins discussed above, partially offset by a $28.2 million increase in other operating expenses. See Note 10, "*Goodwill and Other Intangible Assets*," for information related to the goodwill impairment loss recorded in 2009.

The increase in other operating expenses primarily related to:

- A $24.8 million increase in depreciation and amortization expense, primarily due to the ICC's rate order for PGL and NSG, effective January 28, 2010. This rate order allows earlier 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 reflects the impact of a $2.5 million write-off of certain MGU assets, which is currently pending appeal before the Michigan Court of Appeals.

- A $12.9 million increase in expenses related to energy conservation programs and enhanced efficiency initiatives. This increase includes expenses related to the CIP that were recovered through the MERC rate increase discussed in margins above.

- A $14.7 million increase in employee benefit costs, primarily driven by an increase in other postretirement benefit costs.

- A $7.4 million increase in asset usage charges from IBS related to implementation of both a work asset management system for natural gas operations and an upgrade to an enterprise resource planning system for finance and supply chain services.

- These increases were partially offset by:

    - An approximate $18 million net decrease due to approximately $25 million of lower amortization of the regulatory asset related to environmental cleanup expenditures for manufactured gas plant sites, partially offset by approximately $7 million of amortization related to the regulatory assets recorded as a result of the PGL and NSG bad debt riders. This net decrease was passed through to customers in rates and, therefore, had no impact on earnings.

    - A $7.1 million decrease in restructuring expenses related to a reduction in workforce. See Note 3, "*Restructuring Expense*," for more information.

    - A $6.1 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.

Regulated Electric Utility Segment Operations

(Millions, except degree days)	Year Ended December 31 2011	2010	2009	Change in 2011 Over 2010	Change in 2010 Over 2009
Revenues	**$1,307.3**	$1,338.9	$1,301.6	(2.4)%	2.9 %
Fuel and purchased power costs	**546.3**	563.9	584.5	(3.1)%	(3.5)%
Margins	**761.0**	775.0	717.1	(1.8)%	8.1 %
Operating and maintenance expense	**421.5**	417.2	392.0	1.0 %	6.4 %
Restructuring expense	**0.2**	(0.3)	8.6	N/A	N/A
Depreciation and amortization expense	**88.5**	94.7	90.3	(6.5)%	4.9 %
Taxes other than income taxes	**47.6**	45.6	46.6	4.4 %	(2.1)%
Operating income	**203.2**	217.8	179.6	(6.7)%	21.3 %
Miscellaneous income	**0.8**	1.5	4.8	(46.7)%	(68.8)%
Interest expense	**(41.8)**	(43.9)	(41.6)	(4.8)%	5.5 %
Other expense	**(41.0)**	(42.4)	(36.8)	(3.3)%	15.2 %
Income before taxes	**$ 162.2**	$ 175.4	$ 142.8	(7.5)%	22.8 %
Sales in kilowatt-hours					
Residential	**3,135.6**	3,114.3	3,043.0	0.7 %	2.3 %
Commercial and industrial	**8,520.9**	8,439.6	8,155.5	1.0 %	3.5 %
Wholesale	**4,256.8**	4,994.7	5,079.1	(14.8)%	(1.7)%
Other	**38.4**	39.1	40.0	(1.8)%	(2.3)%
Total sales in kilowatt-hours	**15,951.7**	16,587.7	16,317.6	(3.8)%	1.7 %
Weather – WPS:					
Heating degree days	**7,524**	7,080	7,962	6.3 %	(11.1)%
Cooling degree days	**603**	616	274	(2.1)%	124.8 %
Weather – UPPCO:					
Heating degree days	**8,676**	8,002	9,317	8.4 %	(14.1)%
Cooling degree days	**305**	301	99	1.3 %	204.0 %

2011 Compared with 2010

Margins

Electric margins are defined as electric operating revenues less fuel and purchased power costs. Management believes that electric utility margins provide a more meaningful basis for evaluating utility operations than electric operating revenues. To the extent changes in fuel and purchased power costs are passed through to customers, the changes are offset by comparable changes in operating revenues. Any significant changes in fuel and purchased power costs that are not recovered from customers are explained in the margin discussion below.

Regulated electric utility segment margins decreased $14.0 million, driven by:

- An approximate $18 million decrease in retail margins due to differences between the 2011 WPS rate order and the previous rate order. Although the 2011 rate order included a lower authorized return on common equity, lower rate base, and other reduced costs, which resulted in lower total revenues and margins, the rate order also projected lower total sales volumes, which led to a rate increase on a per-unit basis. The 2011 rate increase, calculated on a per unit basis, was more than offset by the decoupling mechanism due to changes in the rate order that impact the decoupling calculation. For more details on the WPS 2011 rate order, see Note 26, "*Regulatory Environment.*"

- An approximate $5 million decrease in margins from wholesale customers. The decrease was due to lower sales volumes and lower non-fuel revenue requirements driven by a lower return on common equity, lower rate base, and other reduced costs.

- These decreases were partially offset by:

  - An approximate $6 million increase in margins driven by a retail electric rate increase at UPPCO.

- An approximate $3 million increase in margins due to a year-over-year positive impact from the 2010 amortization of a regulatory asset at WPS related to energy efficiency legislation implemented in a prior year.

Operating Income

Operating income at the regulated electric utility segment decreased $14.6 million, driven by the $14.0 million decrease in margins and a $0.6 million increase in operating expenses.

The increase in operating expenses was primarily related to:

- A $4.9 million increase in the amortization of various regulatory deferrals. This increase was offset in revenues, resulting in no impact on earnings.
- A $3.6 million increase in customer assistance expense related to payments made to the Focus on Energy program. The program promotes residential and small business energy efficiency and renewable energy products.
- A $2.0 million increase in taxes other than income taxes, driven by increases in gross receipts taxes and property taxes.
- A $1.9 million increase in electric transmission expense.
- A $1.8 million increase in injuries and damages expenses.
- These increases were substantially offset by:
  - A $7.7 million decrease in employee benefit costs. The decrease was partially due to lower pension expense driven by an increase in contributions, which increased plan assets.
  - A $6.2 million decrease in depreciation and amortization expense. The PSCW approved lower depreciation rates effective January 1, 2011, and we had lower software amortization in 2011.

Other Expense

Other expense decreased $1.4 million, driven by a decrease in interest expense due to the maturity and repayment of $150 million of long-term debt at WPS in August 2011.

2010 Compared with 2009

Margins

Electric margins are defined as electric operating revenues less fuel and purchased power costs. Management believes that electric margins provide a more meaningful basis for evaluating electric utility operations than electric operating revenues. To the extent changes in fuel and purchased power costs are passed through to customers, the changes are offset by comparable changes in operating revenues. Any significant changes in fuel and purchased power costs that are not recovered from customers are explained in the margin discussion below.

Regulated electric utility segment margins increased $57.9 million, driven by:

- An approximate $26 million increase in margins driven by lower fuel and purchased power costs incurred during 2010 as compared with authorized fuel and purchased power cost recovery rates.
- An approximate $21 million combined positive impact of retail electric rate increases at both WPS and UPPCO, effective January 1, 2010.
- An approximate $7 million increase in margins due to a 2.7% increase in sales volumes to residential customers at WPS, primarily related to warmer year-over-year weather during the cooling season, as evidenced by the increase in cooling degree days. Margins were impacted by the year-over-year increase in sales volumes because 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 both years. Therefore, no additional decoupling deferral was allowed for additional shortfalls from authorized margin for the remainder of both years. Under decoupling, WPS is allowed to defer (up to the established cap) the difference between its actual margin and the rate case authorized margin recognized from residential and small commercial and industrial customers.

- An approximate $7 million increase in margins due to a 7.5% increase in sales volumes to large commercial and industrial customers at WPS, primarily related to changes in the business operations of these customers year over year.

- These increases in regulated electric utility segment margins were partially offset by an approximate $2 million decrease in margins from WPS's wholesale customers, primarily due to a decrease in sales volumes.

Operating Income

Operating income at the regulated electric utility segment increased $38.2 million, driven by the $57.9 million increase in margins, partially offset by a $19.7 million increase in operating expenses.

The increase in operating expenses was the result of:

- A $13.9 million increase in electric transmission expense.

- A $12.7 million increase in customer assistance expense related to payments made to the Focus on Energy program. The program promotes residential and small business energy efficiency and renewable energy products.

- A $7.5 million increase in employee benefit costs. The increase was partially due 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 $4.4 million increase in depreciation and amortization expense, primarily related to the Crane Creek Wind Farm being placed in service for accounting purposes in December 2009.

- These increases were partially offset by:

  - An $8.9 million year-over-year decrease in restructuring expenses related to a reduction in workforce. See Note 3, "*Restructuring Expense*," for more information.

  - A $6.2 million decrease in labor costs, driven by the reduction in workforce and company-wide furloughs implemented as part of previously announced cost management efforts.

  - A $2.1 million decrease in electric maintenance expense at WPS, primarily related to a greater number of planned outages at its generation plants during 2009 compared with 2010.

Other Expense

Other expense at the regulated electric utility segment increased $5.6 million, driven by a decrease in AFUDC, primarily related to the construction of the Crane Creek Wind Farm in 2009.

Electric Transmission Investment Segment Operations

2011 Compared with 2010

Miscellaneous Income

Miscellaneous income at the electric transmission investment segment increased $1.5 million. The increase resulted from higher earnings related to our approximate 34% ownership interest in ATC. We earn higher returns each year as ATC continues to increase its rate base by investing in transmission equipment and facilities for improved reliability and economic benefits.

2010 Compared with 2009

Miscellaneous Income

Miscellaneous income at the electric transmission investment segment increased $2.3 million. The increase resulted from higher earnings related to our approximate 34% ownership interest in ATC. We earn higher returns each year as ATC continues to increase its rate base by investing in transmission equipment and facilities for improved reliability and economic benefits.

Integrys Energy Services Nonregulated Segment Operations

(Millions, except natural gas sales volumes)	Year Ended December 31 2011	2010	2009	Change in 2011 Over 2010	Change in 2010 Over 2009
Revenues	**$1,395.9**	$1,823.7	$3,994.0	(23.5)%	(54.3)%
Cost of sales	**1,272.7**	1,614.3	3,696.1	(21.2)%	(56.3)%
Margins	**123.2**	209.4	297.9	(41.2)%	(29.7)%
Margin Detail					
Realized retail electric margins	**98.5**	85.4 [2][4]	82.0 [4]	15.3 %	4.1 %
Realized wholesale electric margins	**(0.2)** [1]	(8.2) [3]	40.3	(97.6)%	N/A
Realized energy asset margins	**31.1**	34.5	37.9	(9.9)%	(9.0)%
Fair value accounting adjustments	**(30.7)**	36.0	29.9	N/A	20.4 %
Electric and other margins	**98.7**	147.7	190.1	(33.2)%	(22.3)%
Realized retail natural gas margins	**49.1**	50.0 [4]	68.7 [4]	(1.8)%	(27.2)%
Realized wholesale natural gas margins	**3.9** [1]	(3.3)	40.8	N/A	N/A
Lower-of-cost-or-market inventory adjustments	**(10.7)**	6.8	155.4	N/A	(95.6)%
Fair value accounting adjustments	**(17.8)**	8.2	(157.1)	N/A	N/A
Natural gas margins	**24.5**	61.7	107.8	(60.3)%	(42.8)%
Operating and maintenance expense	**108.8**	117.6	188.6	(7.5)%	(37.6)%
Impairment losses on property, plant, and equipment	**4.6**	43.2	0.7	(89.4)%	6,071.4 %
Restructuring expense	**1.8**	8.3	27.2	(78.3)%	(69.5)%
Net (gain) loss on Integrys Energy Services' dispositions related to strategy change	**(0.3)**	14.1	28.9	N/A	(51.2)%
Depreciation and amortization	**12.7**	17.2	19.0	(26.2)%	(9.5)%
Taxes other than income taxes	**7.0**	5.0	7.4	40.0 %	(32.4)%
Operating income (loss)	**(11.4)**	4.0	26.1	N/A	(84.7)%
Miscellaneous income	**0.4**	9.1	6.0	(95.6)%	51.7 %
Interest expense	**(2.3)**	(6.7)	(13.1)	(65.7)%	(48.9)%
Other income (expense)	**(1.9)**	2.4	(7.1)	N/A	N/A
Income (loss) before taxes	**$ (13.3)**	$ 6.4	$ 19.0	N/A	(66.3)%
Physically settled volumes					
Retail electric sales volumes in kwh	**12,416.5**	12,647.9 [6]	15,045.3 [6]	(1.8)%	(15.9)%
Wholesale electric sales volumes in kwh	**320.1** [5]	1,319.9	3,965.2	(75.7)%	(66.7)%
Retail natural gas sales volumes in bcf	**125.5**	133.3 [6]	236.7 [6]	(5.9)%	(43.7)%
Wholesale natural gas sales volumes in bcf	-	27.5	402.5	(100.0)%	(93.2)%

kwh – kilowatt-hours
bcf – billion cubic feet

(1) Realized wholesale activity relates to remaining contracts for which offsetting positions were entered into.

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

(3) This amount includes negative margin of $9.3 million related to the settlement of wholesale supply contracts in connection with Integrys Energy Services' strategy change.

(4) Amounts include margins in markets that Integrys Energy Services no longer considers strategic.

(5) Primarily relates to electric generation assets.

(6) Includes physically settled volumes in markets that Integrys Energy Services no longer considers strategic.

2011 Compared with 2010

Revenues

Revenues decreased $427.8 million, driven by lower sales volumes resulting from Integrys Energy Services' strategy change, and lower year-over-year average commodity prices.

Margins

Integrys Energy Services' margins decreased $86.2 million. 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 $13.1 million. Higher margins in the markets that Integrys Energy Services continues to focus on drove the increase. Most of these markets had higher sales volumes and positive results from the change in pricing and customer mix that was implemented as part of Integrys Energy Services' strategy change. The $1.4 million negative impact on margins in 2010 from the settlement of supply contracts also contributed to the year-over-year increase. The increase was partially offset by a decrease in margins related to the sale of the Texas retail electric business in June 2010, resulting from Integrys Energy Services' strategy change.

Fair value accounting adjustments

Derivative accounting rules impact Integrys Energy Services' margins. Fair value adjustments caused a $66.7 million decrease in electric margins year over year. These adjustments primarily relate to physical and financial contracts used to reduce price risk for supply associated with electric sales contracts. These adjustments will reverse in future periods as contracts settle.

Natural Gas Margins

Realized retail natural gas margins

Realized retail natural gas margins decreased $0.9 million. In 2011 there were fewer opportunities to take advantage of natural gas price volatility and changes in market prices for natural gas storage and transportation capacity.

Inventory accounting adjustments

Integrys Energy Services' physical natural gas inventory is valued at the lower of cost or market. When the market price of natural gas is lower than the carrying value of the inventory, write-downs are recorded within margins to reflect inventory at the end of the period at its net realizable value. These write-downs result in higher margins in future periods as the inventory that was written down is sold. The $17.5 million year-over-year decrease in margins from inventory adjustments was driven by an increase in write-downs and lower volume of inventory withdrawn from storage for which write-downs had previously been recorded.

Fair value accounting adjustments

Derivative accounting rules impact Integrys Energy Services' margins. Fair value adjustments caused a $26.0 million decrease in natural gas margins year over year. These adjustments primarily relate to physical and financial contracts used to reduce price risk for supply, storage, and transportation associated with natural gas sales contracts. These adjustments will reverse in future periods as contracts settle.

Operating Income (Loss)

Integrys Energy Services' operating income decreased $15.4 million, driven by the $86.2 million decrease in margins discussed above, partially offset by a $70.8 million decrease in operating expenses.

The decrease in operating expense was primarily related to:

- A $38.6 million decrease in impairment losses recorded on generation plants.
- A $14.4 million decrease due to losses on Integrys Energy Services' dispositions in 2010 related to its strategy change.
- A $6.5 million decrease in restructuring expense.
- A $4.5 million decrease in depreciation and amortization expense, driven by lower book value of the generation plants for which impairment losses were recorded in 2010.

- A $4.7 million decrease in employee payroll and benefit related expenses, primarily due to the reduction in workforce associated with Integrys Energy Services' strategy change.

- A $2.2 million decrease in intercompany fees related to a credit agreement with the holding company.

Other Income (Expense)

Integrys Energy Services' other income decreased $4.3 million. The main driver for the decrease was an $8.7 million decrease in miscellaneous income. This decrease was driven by the negative year-over-year impact of a $4.3 million gain reclassified from accumulated OCI in 2010 related to foreign currency translation adjustments, and a $3.4 million decrease in interest income driven by the holding company's repayment of borrowings from Integrys Energy Services in the first quarter of 2011. The decrease in miscellaneous income was partially offset by a $4.4 million decrease in interest expense driven by reduced business size as a result of Integrys Energy Services' strategy change.

2010 Compared with 2009

Revenues

Revenues decreased $2,170.3 million during 2010, compared with 2009, as a result of our decision to reduce the scale, scope, and risk attributes of Integrys Energy Services by focusing on selected retail electric and natural gas 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 7% and 4% respectively, year over year.

Margins

Integrys Energy Services' margins decreased $88.5 million during 2010, compared with 2009. 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 $3.4 million during 2010, compared with 2009, driven by:

- A $9.2 million increase in margins in the Illinois market, primarily driven by a change in pricing methodology and customer mix that was implemented as part of Integrys Energy Services' strategy change.

- A $5.5 million increase in margins in the Michigan market. This increase was driven by higher sales volumes due to increased marketing efforts.

- The above increases in realized retail electric margins were partially offset by a $9.0 million decrease in margins related to the sale of the Texas retail electric business in June 2010, driven by reduced sales volumes and a $1.4 million decrease related to the settlement of supply contracts. See Note 5, "*Dispositions*," for a discussion of this sale.

Realized wholesale electric margins

Realized wholesale electric margins decreased $48.5 million year over year, including negative margins of $9.3 million in 2010 related to the settlement of wholesale supply contracts in connection with Integrys Energy Services' strategy change. 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. See Note 5, "*Dispositions*," for more information on Integrys Energy Services' sale of its United States wholesale electric marketing and trading business.

Fair value accounting adjustments

Derivative accounting rules impact Integrys Energy Services' margins. Fair value adjustments caused a $6.1 million increase in electric margins year over year. These adjustments primarily relate to physical and financial contracts used to reduce price risk for supply associated with electric sales contracts.

Natural Gas Margins

Realized retail natural gas margins

Realized retail natural gas margins decreased $18.7 million during 2010, compared with 2009, driven by:

- A $7.6 million decrease driven by reduced sales volumes due to the sale of Integrys Energy Services' Canadian retail natural gas portfolio in September 2009. See Note 5, "*Dispositions*," for a discussion of this sale.

- A $7.5 million decrease in margins in the Illinois market, primarily due to the negative year-over-year impact of the withdrawal of a significant amount of natural gas from storage in the first half of 2009, resulting in higher realized margins during that period. Also contributing to the decrease were lower sales volumes resulting from Integrys Energy Services' strategy change.

Realized wholesale natural gas margins

Realized wholesale natural gas margins decreased $44.1 million year over year due to Integrys Energy Services completing the sale of substantially all of its wholesale natural gas business in December 2009. Additional components of the wholesale natural gas business were sold in March 2010 and May 2010. The remaining realized wholesale natural gas activity at Integrys Energy Services is related to residual contracts that will settle in the first half of 2011. The risks associated with these residual contracts are economically hedged. See Note 5, "*Dispositions*," for more information on Integrys Energy Services' sale of its wholesale natural gas business.

Inventory accounting adjustments

Integrys Energy Services' physical natural gas inventory is valued at the lower of cost or market. When the market price of natural gas is lower than the carrying value of the inventory, write-downs are recorded within margins to reflect inventory at the end of the period at its net realizable value. These write-downs result in higher margins in future periods as the inventory that was written down is sold. The $148.6 million year-over-year decrease in margins from inventory adjustments was driven by a lower volume of inventory withdrawn from storage in 2010 for which write-downs had previously been recorded.

Fair value accounting adjustments

Derivative accounting rules impact Integrys Energy Services' margins. Fair value adjustments caused a $165.3 million increase in natural gas margins year over year. These adjustments primarily relate to physical and financial contracts used to reduce price risk for supply, storage, and transportation associated with natural gas sales contracts.

Operating Income (Loss)

Integrys Energy Services' operating income decreased $22.1 million year over year, driven by the $88.5 million decrease in margins discussed above, and a $43.2 million noncash impairment loss related to three natural gas-fired generation plants in the third quarter of 2010. These decreases were partially offset by a $71.0 million decrease in operating and maintenance expense, an $18.9 million decrease in restructuring expense, and a $14.8 million decrease in the net loss on Integrys Energy Services' dispositions related to its strategy change (which primarily resulted from mark-to-market timing differences that have historically caused earnings volatility at Integrys Energy Services).

The decrease in operating and maintenance expense was driven by:

- A $46.0 million year-over-year decrease in employee payroll and benefit related expenses, primarily due to the reduction in workforce associated with Integrys Energy Services' strategy change.

- A $10.5 million year-over-year decrease in bad debt expense driven by the partial recovery in 2010 of receivables fully reserved in prior years, and a decrease in reserves resulting from reduced business activity.

- The $9.0 million positive year-over-year impact of a fee incurred in the second quarter of 2009 related to an agreement with a counterparty that enabled Integrys Energy Services to reduce collateral support requirements.

- An $8.0 million year-over-year decrease in broker commissions, contractor expenses, and various other fees, resulting from reduced business activity associated with Integrys Energy Services' strategy change.

- The above decreases in operating and maintenance expense were partially offset by $8.1 million of intercompany fees related to a credit agreement established in 2010 with the holding company.

Other Income (Expense)

Integrys Energy Services' other income increased $9.5 million year over year, driven by a $4.3 million gain reclassified from accumulated other comprehensive income in 2010 related to foreign currency translation adjustments recorded in prior periods, as well as a $6.4 million decrease in interest expense driven by reduced business size, as a result of Integrys Energy Services' strategy change.

Holding Company and Other Segment Operations

(Millions)	Year Ended December 31 2011	2010	2009	Change in 2011 Over 2010	Change in 2010 Over 2009
Operating income (loss)	$ 5.7	$ 8.3	$ (1.9)	(31.3)%	N/A
Other expense	(34.0)	(45.9)	(58.1)	(25.9)%	(21.0)%
Net loss before taxes	$(28.3)	$(37.6)	$(60.0)	(24.7)%	(37.3)%

2011 Compared with 2010

Operating Income

Operating income at the holding company and other segment decreased $2.6 million. The decrease was driven primarily by lower intercompany fees charged by the holding company to Integrys Energy Services related to lower interest charges and decreased use of an intercompany credit agreement.

Other Expense

Other expense at the holding company and other segment decreased $11.9 million. Interest expense on long-term debt decreased, driven by both lower interest rates on debt refinanced and lower average outstanding long-term debt in 2011.

2010 Compared with 2009

Operating Income (Loss)

Operating income at the holding company and other segment increased $10.2 million, driven by $8.1 million of intercompany fees charged by the holding company to Integrys Energy Services related to a credit agreement established in 2010.

Other Expense

Other expense at the holding company and other segment decreased $12.2 million, driven by a $14.6 million decrease in external interest expense.

Provision for Income Taxes

	Year Ended December 31 2011	2010	2009
Effective Tax Rate	36.7%	39.9%	624.6%

2011 Compared with 2010

Our effective tax rate decreased during 2011. In the fourth quarter of 2011, we reduced the provision for income taxes by $5.8 million when we recorded a regulatory asset related to deferred income taxes previously expensed as part of the 2010 federal health care reform. We were authorized recovery of these income taxes through our recently approved rate order for PGL and NSG. As discussed below, we expensed $10.8 million of deferred income taxes as a result of the federal health care reform in 2010. See "*Liquidity and Capital Resources, Other Future Considerations – Federal Health Care Reform*" for more information. The decrease in the effective tax rate during 2011 was partially offset when we increased our provision for income taxes and deferred income tax liabilities by $6.0 million for tax law changes in Michigan and Wisconsin. See "*Liquidity and Capital Resources, Other Future Considerations – Recent Tax Law Changes*" for more information.

For information on changes in the deferred income tax balances, see Note 15, "Income Taxes."

2010 Compared with 2009

Our effective tax rate decreased during 2010. The rate decreased primarily because a significant portion of our $291.1 million noncash pre-tax goodwill impairment loss recorded in 2009 was not deductible for tax purposes. Partially offsetting this decrease in the effective tax rate was the 2010 federal health care reform. This legislation eliminated the tax deduction for retiree prescription drug payments that are paid by employers and are offset by the receipt of a federal Medicare Part D subsidy. See "*Liquidity and Capital Resources, Other Future Considerations – Federal Health Care Reform*" for more information. As a result, we expensed $10.8 million of deferred income taxes during 2010. This amount excluded $1.0 million for which UPPCO was authorized recovery from ratepayers.

Discontinued Operations, Net of Tax

2011 Compared with 2010

Income from discontinued operations, net of tax, decreased $0.6 million in 2011. During 2011, we remeasured an unrecognized tax benefit liability related to the 2007 sale of Peoples Energy Production Company, including an adjustment for a lapse in the statute of limitations for certain states associated with these tax filings.

2010 Compared with 2009

Income from discontinued operations, net of tax, decreased $2.6 million in 2010. During 2009, Integrys Energy Services recognized a $3.9 million ($2.4 million after tax) gain on the sale of its energy management consulting business in discontinued operations. During 2010, Integrys Energy Services recorded a $0.2 million after-tax gain in discontinued operations when contingent payments were earned related to the sale of this business.

For more information on the discontinued operations discussed above, see Note 5, "*Dispositions,*" and Note 27, "*Segments of Business.*"

LIQUIDITY AND CAPITAL RESOURCES

We believe we have adequate resources to fund ongoing operations and future capital expenditures. These resources include our cash balances, liquid assets, operating cash flows, access to equity and debt capital markets, and available borrowing capacity. Our borrowing costs can be impacted by short-term and long-term debt ratings assigned by independent credit rating agencies, as well as the market rates for interest. Our operating cash flows and access to capital markets can be impacted by macroeconomic factors outside of our control.

Operating Cash Flows

2011 Compared with 2010

Net cash provided by operating activities was $721.9 million during 2011, compared with $725.2 million during 2010. The $3.3 million decrease in net cash provided by operating activities was mainly driven by:

- Net cash used for working capital of $34.2 million in 2011, compared with $40.8 million of net cash provided by working capital in 2010. The $75.0 million year-over-year increase in working capital requirements was primarily due to:
  - A $17.3 million increase in cash collateral provided to counterparties in 2011, compared with a $163.6 million decrease in cash collateral provided in 2010, primarily due to the change in Integrys Energy Services' business related to its strategy change.
  - Inventory levels increased $28.0 million in 2011, compared to a decrease of $51.1 million in 2010. The increase in inventory in 2011 was driven by warmer weather at the end of 2011 compared to the end of 2010, which impacted inventory levels at PGL and NSG, and increased coal freight costs at WPS. The decrease in inventory in 2010 was largely due to the impact of the Integrys Energy Services' strategy change.
  - Partially offsetting these changes was the positive impact from a $46.2 million decrease in other current assets in 2011, compared with an $85.5 million increase in other current assets in 2010. This change was driven by the year-over-year increase in net cash received for income taxes, which was primarily due to the 100% bonus tax depreciation allowed in 2011.
  - Also partially offsetting these changes was a $68.4 million year-over-year positive impact from the change in other current liabilities. The change was driven by the return of collateral to counterparties in 2010 as a result of Integrys Energy Services' strategy change.

- The net increase in working capital requirements was partially offset by a $70.3 million net decrease in contributions to pension and other postretirement benefit plans.

2010 Compared with 2009

Net cash provided by operating activities was $725.2 million during 2010, compared with $1,606.3 million during 2009. The $881.1 million decrease in net cash provided by operating activities was mainly driven by:

- A $746.5 million net decrease in cash provided by working capital, driven by:
  - A $767.2 million year-over-year decrease in cash generated from customer collections, primarily due to the Integrys Energy Services strategy change, as well as lower year-over-year natural gas prices, which impacted both the regulated natural gas segment and Integrys Energy Services.
  - A $393.0 million year-over-year decrease in cash generated from reduced inventory levels, mainly the result of the withdrawal of a significant amount of natural gas from storage at Integrys Energy Services during 2009 in order to improve its liquidity position.
  - Partially offsetting these changes was a $578.9 million year-over-year decrease in cash used to pay accounts payable balances, driven by smaller accounts payable balances at Integrys Energy Services as a result of the strategy change, as well as lower year-over-year natural gas prices.
  - Also offsetting these changes was a year-over-year increase in cash flows of $118.1 million due to a decrease in cash collateral provided to counterparties, due primarily to the change in Integrys Energy Services' business related to its strategy change.
- A $175.8 million year-over-year increase in deferred income taxes and investment tax credits, primarily driven by a change in tax accounting related to capitalization of overhead costs and legislation providing for bonus depreciation during 2010.
- A $148.5 million year-over-year increase in contributions to pension and other postretirement benefit plans.

Investing Cash Flows

2011 Compared with 2010

Net cash used for investing activities was $394.8 million during 2011, compared with $199.7 million during 2010. The $195.1 million increase in net cash used for investing activities was primarily driven by:

- A $58.4 million decrease in proceeds received from the sale or disposal of assets. The proceeds received in 2010 primarily related to the Integrys Energy Services' strategy change.
- A $52.6 million increase in cash used to fund capital expenditures (discussed below).
- In 2011, $42.6 million of net cash was used for the acquisition of the Pinnacle and Trillium compressed natural gas fueling businesses.
- A $30.7 million year-over-year increase in capital contributions to equity method investments, mainly due to increased contributions to INDU Solar Holdings, LLC.

2010 Compared with 2009

Net cash used for investing activities was $199.7 million during 2010, compared with $440.7 million during 2009. The $241.0 million decrease in net cash used for investing activities was primarily driven by:

- A $185.4 million decrease in cash used to fund capital expenditures (discussed below).
- A $27.2 million year-over-year decrease in capital contributions to equity method investments, mainly related to ATC capital contributions.
- A year-over-year increase in proceeds received from the sale or disposal of assets, primarily related to Integrys Energy Services' strategy change. For more information on these dispositions, see Note 5, "*Dispositions*."

Capital Expenditures

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

Reportable Segment *(millions)*	2011	2010	2009
Electric utility	**$ 84.1**	$ 87.2	$250.4
Natural gas utility	**199.3**	133.6	136.9
Integrys Energy Services	**18.0**	15.2	22.4
Holding company and other	**10.0**	22.8	34.5
Integrys Energy Group consolidated	**$311.4**	$258.8	$444.2

The increase in capital expenditures at the natural gas utility segment in 2011 compared with 2010 was primarily a result of the AMRP at PGL. Partially offsetting this increase was a decrease in capital expenditures at the holding company and other segment, primarily due to lower software project expenditures in 2011.

The decrease in capital expenditures at the electric utility segment in 2010 compared with 2009 was primarily due to decreased expenditures related to the Crane Creek Wind Farm project, which was placed in service for accounting purposes in December 2009. The decrease in capital expenditures at the holding company and other segment was mainly due to lower expenditures in 2010 related to software projects.

Financing Cash Flows

2011 Compared with 2010

Net cash used for financing activities was $478.4 million during 2011, compared with $391.4 million during 2010. The $87.0 million increase in net cash used for financing activities was primarily driven by:

- A $648.6 million increase due to $515.8 million of net repayments of long-term debt in 2011, compared with $132.8 million of net long-term issuances in 2010.
- A $28.3 million decrease in cash provided by the issuance of common stock. See "*Significant Financing Activities*" for more information.
- A $20.3 million increase in cash used for the payment of common stock dividends.
- A $15.4 million decrease in net proceeds from the sale of borrowed natural gas related to the strategy change at Integrys Energy Services.

Partially offsetting these increases in net cash used were:

- A $505.4 million decrease due to $293.3 million of net borrowings of short-term debt and notes payable in 2011, compared with $212.1 million of net repayments in 2010.
- A $125.9 million decrease in payments related to the divestitures of the nonregulated wholesale electric and natural gas businesses. In 2010, $27.8 million was paid to the buyers upon the sale of these businesses. No such payments were made in 2011. The remaining $98.1 million decrease related to the settlement of certain contracts that were executed at the time of sale.

2010 Compared with 2009

Net cash used for financing activities was $391.4 million during 2010, compared with $1,378.4 million during 2009. The $987.0 million year-over-year decrease in net cash used for financing activities was primarily driven by:

- A $761.5 million year-over-year decrease in the net repayment of short-term borrowings.
- A $298.6 million decrease due to net natural gas loan proceeds at Integrys Energy Services of $15.4 million during 2010, compared with the net repayment of $283.2 million of natural gas loans during 2009.

- Partially offsetting these changes were $157.8 million of payments made during 2010 to buyers of the wholesale natural gas and electric businesses and payments for settlement of out-of-the-money transactions that were executed at the time of sale, compared with $33.9 million of proceeds received upon the sale of substantially all of the wholesale natural gas business during 2009. The out-of-the-money transactions were replacement supply trades for the retained retail operations and were transacted at the original transfer price between Integrys Energy Services' wholesale and retail businesses. Payments made to the buyers to settle the replacement supply contracts were funded with proceeds received from the settlement of the related retail electric and retail natural gas sales contracts.

Significant Financing Activities

Our quarterly common stock dividend of $0.68 per share in 2011 remained the same as in 2010.

From January 1, 2010 through February 10, 2010, shares were purchased on the open market to meet the requirements of our Stock Investment Plan and certain stock-based employee benefit and compensation plans. From February 11, 2010 through April 30, 2011, we issued new shares of common stock to meet the requirements of these plans. Beginning May 1, 2011, shares were again purchased on the open market to meet the requirements of these plans.

We had $303.3 million in outstanding commercial paper borrowings at December 31, 2011, and none outstanding at December 31, 2010. We had no short-term notes payable outstanding at December 31, 2011, and $10.0 million outstanding at December 31, 2010. We had no borrowings under revolving credit facilities at December 31, 2011, and 2010. See Note 12, "*Short-Term Debt and Lines of Credit,*" for more information.

For information on the issuance and redemption of our long-term debt and that of our subsidiaries, see Note 13, "*Long-Term Debt.*"

We use internally generated funds, commercial paper borrowings, and other short-term borrowings to satisfy most of our capital requirements. We also periodically issue long-term debt and common stock to reduce short-term debt, maintain desired capitalization ratios, and fund future growth.

We have our own commercial paper borrowing programs, as do WPS and PGL.

WPS periodically issues long-term debt to reduce short-term debt, fund future growth, and maintain capitalization ratios as authorized by the PSCW.

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

Credit Ratings

Our current credit ratings and the credit ratings for WPS, PGL, and NSG are listed in the table below:

Credit Ratings	**Standard & Poor's**	**Moody's**
Integrys Energy Group		
Issuer credit rating	A-	N/A
Senior unsecured debt	BBB+	Baa1
Commercial paper	A-2	P-2
Credit facility	N/A	Baa1
Junior subordinated notes	BBB	Baa2
WPS		
Issuer credit rating	A-	A2
First mortgage bonds	N/A	Aa3
Senior secured debt	A	Aa3
Preferred stock	BBB	Baa1
Commercial paper	A-2	P-1
Credit facility	N/A	A2
PGL		
Issuer credit rating	A-	A3
Senior secured debt	A-	A1
Commercial paper	A-2	P-2
NSG		
Issuer credit rating	A-	A3
Senior secured debt	A	A1

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

On January 24, 2012, Standard & Poor's raised the issuer credit ratings for us, PGL, and NSG to "A-" from "BBB+." In addition, they raised our senior unsecured debt rating to "BBB+" from "BBB" and raised our junior subordinated notes rating to "BBB" from "BBB-." The outlook for us, PGL, and NSG was revised to "stable" from "positive." According to Standard & Poor's, the revised ratings reflect their view that our business risk profile improved to "excellent" from "strong" and that we continue to have a significant financial risk profile. The revised business risk profile assessment reflects the successful implementation of our strategic initiative to reduce our exposure to the nonutility businesses and our effective management of regulatory risk. WPS's outlook remained "stable."

On May 27, 2010, Moody's revised the outlook for us and all of our subsidiaries to "stable" from "negative." According to Moody's, the revised outlook reflected a reduced business risk profile driven by the recently completed restructuring of Integrys Energy Services into a smaller segment with significantly reduced collateral requirements. Moody's also raised the following ratings of our subsidiaries:

- The senior secured debt rating and first mortgage bonds rating of WPS were raised from "A1" to "Aa3."
- The senior secured debt ratings of PGL and NSG were raised from "A2" to "A1."

According to Moody's, the upgrade follows the August 2009 upgrade of the senior secured ratings of the majority of its investment grade regulated utilities (issuers with negative outlooks were excluded from the August 2009 upgrade).

Future Capital Requirements and Resources

Contractual Obligations

The following table shows our contractual obligations as of December 31, 2011, including those of our subsidiaries.

		Payments Due By Period			
(Millions)	Total Amounts Committed	2012	2013 to 2014	2015 to 2016	2017 and Thereafter
Long-term debt principal and interest payments [1]	$2,975.2	$ 358.1	$ 581.0	$ 633.9	$1,402.2
Operating lease obligations	81.6	8.5	13.8	8.1	51.2
Commodity purchase obligations [2]	2,669.0	700.5	707.7	345.6	915.2
Capital contributions to equity method investment	3.4	3.4	-	-	-
Purchase orders [3]	418.2	416.8	1.4	-	-
Pension and other postretirement funding obligations [4]	820.6	289.5	201.1	60.0	270.0
Total contractual cash obligations	$6,968.0	$1,776.8	$1,505.0	$1,047.6	$2,638.6

(1) Represents bonds and notes issued, as well as loans made to us and our subsidiaries. We record all principal obligations on the balance sheet. For purposes of this table, it is assumed that the current interest rates on variable rate debt will remain in effect until the debt matures.

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

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

(4) Obligations for pension and other postretirement benefit plans, other than the Integrys Energy Group Retirement Plan, cannot reasonably be estimated beyond 2014.

The table above does not reflect payments related to the manufactured gas plant remediation liability of $613.7 million at December 31, 2011, as the amount and timing of payments are uncertain. We expect to incur costs annually to remediate these sites. See Note 16, "*Commitments and Contingencies,*" for more information about environmental liabilities. The table also does not reflect payments for the December 31, 2011, liability of $22.4 million related to unrecognized tax benefits, as the amount and timing of payments are uncertain. See Note 15, "*Income Taxes,*" for more information on unrecognized tax benefits.

Capital Requirements

As of December 31, 2011, our subsidiaries' capital expenditures for the three-year period 2012 through 2014 were expected to be as follows:

(Millions)	
WPS	
Environmental projects	$ 510.7
Electric and natural gas distribution projects	201.1
Electric and natural gas delivery and customer service projects	63.7
Other projects	176.0
UPPCO	
Repairs and safety measures at hydroelectric facilities	16.6
Other projects	31.7
MGU	
Natural gas pipe distribution system, underground natural gas storage facilities, and other projects	34.8
MERC	
Natural gas pipe distribution system and other projects	53.2
PGL	
Natural gas pipe distribution system, underground natural gas storage facilities, and other projects	699.9
NSG	
Natural gas pipe distribution system and other projects	85.2
Integrys Energy Services	
Solar and other projects	98.6
IBS	
Corporate services infrastructure projects	96.2
ITF	
Compressed natural gas fueling stations	71.0
Total capital expenditures	$2,138.7

We expect to provide capital contributions to INDU Solar Holdings, LLC, (not included in the above table) of approximately $45 million in 2012. INDU Solar Holdings was created in October 2010, through wholly owned subsidiaries of both Integrys Energy Services and Duke Energy Generation Services, to build and finance distributed solar projects throughout the United States.

We expect to provide capital contributions to ATC (not included in the above table) of approximately $15 million from 2012 through 2014.

All projected capital and investment expenditures are subject to periodic review and may vary significantly from the estimates, depending on a number of factors. These factors include, but are not limited to, industry restructuring, regulatory constraints and requirements, changes in tax laws and regulations, acquisition and development opportunities, market volatility, and economic trends.

Capital Resources

Management prioritizes the use of capital and debt capacity, determines cash management policies, uses risk management policies to hedge the impact of volatile commodity prices, and makes decisions regarding capital requirements in order to manage the liquidity and capital resource needs of the business segments. We plan to meet our capital requirements for the period 2012 through 2014 primarily through internally generated funds (net of forecasted dividend payments) and debt and equity financings. We plan to keep debt to equity ratios at levels that can support current credit ratings and corporate growth. We believe we have adequate financial flexibility and resources to meet our future needs.

Under an existing shelf registration statement, we may issue debt, equity, certain types of hybrid securities, and other financial instruments with amounts, prices, and terms to be determined at the time of future offerings.

Under an existing shelf registration statement, WPS may issue up to $500.0 million of senior debt securities with amounts, prices, and terms to be determined at the time of future offerings.

At December 31, 2011, we and each of our subsidiaries were in compliance with all covenants related to outstanding short-term and long-term debt. We expect to be in compliance with all such debt covenants for the foreseeable future. See Note 12, "*Short-Term Debt and Lines of Credit,*" for more information on credit facilities and other short-term credit agreements, including short-term debt covenants. See Note 13, "*Long-Term Debt,*" for more information on long-term debt and related covenants.

Various laws, regulations, and financial covenants impose restrictions on the ability of certain of our regulated utility subsidiaries to transfer funds to us in the form of dividends. Our regulated utility subsidiaries are prohibited from loaning funds to us, either directly or indirectly. Although these restrictions limit the amount of funding the various operating subsidiaries can provide to us, management does not believe these restrictions will have a significant impact on our ability to access cash for payment of dividends on common stock or other future funding obligations. See Note 20, "*Common Equity,*" for more information on dividend restrictions.

Other Future Considerations

Decoupling

In certain jurisdictions, decoupling mechanisms have been implemented. These mechanisms differ state by state and allow utilities to adjust future rates to recover or refund all or a portion of the differences between actual and authorized margin.

- Decoupling for residential and small commercial and industrial sales was approved by the ICC on a four-year trial basis for PGL and NSG, effective March 1, 2008. Interveners, including the Illinois Attorney General, oppose decoupling and have appealed the ICC's approval. PGL and NSG actively support the ICC's decision to approve decoupling. In the PGL and NSG rate order approved on January 10, 2012, the ICC made the decoupling mechanism (based on total margin) permanent for both companies. The appeal of the original decoupling order is pending and, depending on the outcome, could impact the current rate order provision for decoupling.

- Decoupling for natural gas and electric residential and small commercial and industrial sales was approved by the PSCW on a four-year trial basis for WPS, effective January 1, 2009, and ending on December 31, 2012. The mechanism does not adjust for variations in volumes resulting from changes in customer count compared to rate case levels, nor does it cover all customer classes. This decoupling mechanism includes an annual $14.0 million cap for electric service and an annual $8.0 million cap for natural gas service. Amounts recoverable from or refundable to customers are subject to these caps and are included in rates upon approval in a rate order. WPS expects to address decoupling beyond 2012 in its rate case filing for 2013.

- Decoupling for UPPCO was approved for the majority of customer classes by the MPSC, effective January 1, 2010, and ended on December 31, 2011. A new weather-normalized decoupling mechanism based on total margin will become effective for UPPCO on January 1, 2013. UPPCO has no decoupling mechanism in place for 2012.

- The MPSC granted an order, effective January 1, 2010, approving a decoupling mechanism for MGU that covers residential and small commercial and industrial customers. The decoupling mechanism does not adjust for weather-related usage, nor does it adjust for variations in volumes resulting from changes in customer count compared to rate case levels. The decoupling mechanism does not cover all customer classes.

- In Minnesota, MERC proposed a decoupling mechanism in its November 30, 2010 general rate case filing. A final order is expected in the second quarter of 2012.

See Note 26, "*Regulatory Environment,*" for more information.

Climate Change

The EPA began regulating greenhouse gas emissions under the Clean Air Act in January 2011 by applying the Best Available Control Technology (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. Therefore, the EPA issued guidance that defines BACT in terms of improvements in energy efficiency as opposed to relying on pollution control equipment. In December 2010, the EPA announced its intent to develop new source performance standards for greenhouse gas emissions. The standards would apply to new and modified, as well as existing, electric utility steam generating units. The EPA planned to propose these standards in 2011 and finalize them in 2012; however, the proposal has since been delayed.

A risk exists that any greenhouse gas legislation or regulation will increase the cost of producing energy using fossil fuels. However, we believe the capital expenditures being made at our plants are appropriate under any reasonable mandatory greenhouse gas program. We also believe that future expenditures by our regulated electric and natural gas utilities that may be required to control greenhouse gas emissions or meet renewable portfolio standards will be recoverable in rates. We will continue to monitor and manage potential risks and opportunities associated with future greenhouse gas legislative or regulatory actions.

The majority of our generation and distribution facilities are located in the upper Midwest region of the United States. The same is true for the majority of our customers' facilities. The physical risks posed by climate change for these areas are not expected to be significant at this time. Ongoing evaluations will be conducted as more information on the extent of such physical changes becomes available.

Property Tax Assessment on Natural Gas

Our subsidiaries and natural gas retailers purchase storage services from pipeline companies on interstate systems. Some states tax natural gas held as working natural gas in facilities located within their jurisdiction as personal property. Shippers that are being assessed a tax are actively protesting these property tax assessments. MERC is currently pursuing a protest through litigation in Kansas.

Federal Health Care Reform

In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (HCR) were signed into law. HCR contains various provisions that will affect the cost of providing health care coverage to our active and retired employees and their dependents. Although these provisions become effective at various times over the next 10 years, some provisions that affect the cost of providing benefits to retirees were reflected in our financial statements in 2010 and 2011.

Beginning in 2013, a provision of HCR will eliminate the tax deduction for employer-paid postretirement prescription drug charges to the extent those charges will be offset by the receipt of a federal Medicare Part D subsidy. As a result, we eliminated $11.8 million of our deferred tax asset related to postretirement benefits in 2010. Of this amount, $10.8 million flowed through to net income as a component of income tax expense in 2010. The remaining $1.0 million was deferred for regulatory recovery at UPPCO. An additional $1.5 million was expensed in June 2011 for deferred income taxes related to a Wisconsin tax law change (see discussion in Recent Tax Law Changes below). In the fourth quarter of 2011, PGL and NSG recorded a regulatory asset of $5.8 million, reversing amounts previously expensed in 2010, as PGL and NSG were authorized recovery of these amounts in the rate order approved on January 10, 2012. In addition, WPS was authorized recovery in February 2012 for the portion related to its Michigan operations that was previously expensed in 2010. We expect to seek rate recovery for the remaining $5.9 million of income tax expense that relates to this tax law change associated with our regulated operations. If recovery in rates becomes probable in the remaining jurisdiction, income tax expense will be reduced in that period. We are not currently able to predict how much of the remaining portion, if any, will be recovered in rates.

Other provisions of HCR include the elimination of certain annual and lifetime maximum benefits and the broadening of plan eligibility requirements. It also includes the elimination of pre-existing condition restrictions, an excise tax on high-cost health plans, changes to the Medicare Part D prescription drug program, and numerous other changes. We participate in the Early Retiree Reinsurance Program that became effective on June 1, 2010. We continue to assess the extent to which the provisions of the new law will affect our future health care and related employee benefit plan costs.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

The Dodd-Frank Act was signed into law in July 2010. However, significant rulings essential to its framework still remain outstanding. Depending on the final rules, certain provisions of the Dodd-Frank Act relating to derivatives could increase capital and/or collateral requirements. Final rules for these provisions are expected in the second quarter of 2012. We are monitoring developments related to this act and their impacts on our future financial results.

Recent Tax Law Changes

Federal

In December 2010, President Obama signed into law The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. This act includes tax incentives, such as an extension and increase of bonus depreciation, the extension of the research and experimentation credit, and the extension of treasury grants in lieu of claiming the investment tax credit or production tax credit for certain renewable energy investments. In September 2010, President Obama signed into law the Small Business Jobs Act of 2010. This act includes tax incentives, such as an extension to bonus depreciation and changes to listed property, that affect us. We anticipate that these tax law changes will likely result in $140.0 million to $240.0 million of reduced cash payments for taxes during 2012. These tax incentives may also reduce utility rate base and, thus, future earnings relative to prior expectations. We have primarily used the proceeds from these incentives to make incremental contributions to our various employee benefit plans. In addition, these tax incentives have helped reduce our financing needs.

In December 2011, the National Defense Authorization Act (NDAA) was enacted. The most significant provision of the NDAA was to retroactively eliminate the application of the tax normalization rule for cash grants taken by a regulated utility in lieu of the investment tax credit or production tax credits. Prior to the enactment of NDAA, a regulated utility would have been required to amortize the grant in rates over the regulatory life of the renewable energy generating plant. Further, the allowed rate of return on the generating plant could not be reduced by the unamortized grant balance during the life of the plant. As a result of the enactment of NDAA, we are evaluating our options for taking advantage of cash grants in lieu of the production tax credits we are currently claiming for WPS's Crane Creek wind project.

Illinois

In January 2011, Governor Quinn signed into law the Taxpayer Accountability and Budget Stabilization Act. This act increased the corporate combined income tax rate from 7.3% to 9.5% retroactive to January 1, 2011. The rate decreases to 7.75% after 2014 and returns to 7.3% after 2024. We adjusted deferred taxes to reflect the changes in the tax rate in the first quarter of 2011. Due to the effects of regulation, and the timing of the January 10, 2012 rate order for PGL and NSG, we do not expect a material impact on income from this legislation.

Michigan

In May 2011, Governor Snyder signed legislation that replaced Michigan's business tax with a state income tax, effective January 1, 2012. In accounting for this tax law change, we expensed $4.4 million of deferred income taxes in 2011 primarily related to our nonregulated operations and our unitary filings. We deferred an additional $4.2 million in 2011 for recovery in future rates.

Wisconsin

In June 2011, Governor Walker signed into law a two-year budget bill. Under the bill, the Wisconsin tax code was changed to conform to the federal tax code, retroactive to December 2010. In accounting for this tax law change, we expensed an additional $1.5 million of deferred income taxes in 2011 related to the Medicare Part D subsidy. The legislation also contains favorable provisions related to the carryforward of net operating losses prior to 2008.

OFF BALANCE SHEET ARRANGEMENTS

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

CRITICAL ACCOUNTING POLICIES

We have determined that the following accounting policies are critical to the understanding of our financial statements because their application requires significant judgment and reliance on estimations of matters that are inherently uncertain. Our management has discussed these critical accounting policies with the Audit Committee of the Board of Directors.

Risk Management Activities

We have entered into contracts that are accounted for as derivatives. All derivative contracts are recorded at fair value on the balance sheets, unless they qualify for the normal purchases and sales exception, which provides that recognition of gains and losses in the financial statements is not required until the settlement of the contracts. Changes in fair value, except effective portions of derivative instruments designated as hedges or qualifying for regulatory deferral, generally affect net income attributed to common shareholders at each financial reporting date until the contracts are ultimately settled.

At December 31, 2011, those derivatives not designated as hedges were primarily commodity contracts used to manage price risk associated with natural gas and electricity purchase and sale activities. Cash flow hedge accounting treatment may be used to protect against changes in interest rates. Fair value hedge accounting may be used when we hold assets, liabilities, or firm commitments and enter into transactions that hedge the risk of changes in commodity prices or interest rates. To the extent that the hedging instrument is fully effective in offsetting the transaction being hedged, there is no impact on net income attributed to common shareholders prior to settlement of the hedge.

We have based our valuations on observable inputs whenever possible. However, at times, the valuation of certain derivative instruments requires the use of internally developed valuation techniques and/or significant unobservable inputs. These valuations require a significant amount of management judgment and are classified as Level 3 measurements. Of the total risk management assets on our balance sheets, $14.9 million (5.1%) were classified as Level 3 measurements. Of the total risk management liabilities, $22.8 million (5.5%) were classified as Level 3 measurements. We believe these valuations represent the fair values of these instruments as of the reporting date; however, the actual amounts realized upon settlement of these instruments could vary materially from the reported amounts due to movements in market prices and changes in the liquidity of certain markets.

As a component of fair value determinations, we consider counterparty credit risk, our own credit risk, and liquidity risk. The liquidity component of the fair value determination may be especially subjective when limited liquid market information is available. Changes in the underlying assumptions for the credit and liquidity risk components of fair value at December 31, 2011, would have had the following effects:

Change in Risk Components	Effect on Fair Value of Net Risk Management Liabilities at December 31, 2011 *(Millions)*
100% increase	$5.0 decrease
50% decrease	$2.5 increase

These hypothetical changes in fair value would be included in current and long-term assets and liabilities from risk management activities on the balance sheets and as part of nonregulated revenues on the income statements.

As of July 1, 2011, Integrys Energy Services discontinued the use of cash flow hedge accounting. See Note 2, "*Risk Management Activities*" for further discussion.

Goodwill Impairment

We completed our annual goodwill impairment tests for all of our reporting units that carry a goodwill balance as of April 1, 2011. No impairment was recorded as a result of these tests. For all of our reporting units, the fair value calculated in step one of the test was greater than the carrying value. The fair value was calculated using an equal weighting of the income approach and the market approach.

For the income approach, we used internal forecasts to project cash flows. Any forecast contains a degree of uncertainty, and changes in these cash flows could significantly increase or decrease the fair value of a reporting unit. For the regulated reporting units, a fair recovery of and return on costs prudently incurred to serve customers is assumed. An unfavorable outcome in a rate case could cause the fair value of these reporting units to decrease.

Key assumptions used in the income approach included return on equity for the regulated reporting units, long-term growth rates used to determine terminal values at the end of the discrete forecast period, and discount rates. The discount rate is applied to estimated future cash flows and is one of the most significant assumptions used to determine fair value under the income approach. As interest rates rise, the calculated fair values will decrease. The discount rate is determined based on the weighted-average cost of capital for each reporting unit, taking into account both the after-tax cost of debt and cost of equity. The terminal year return on equity (ROE) for each utility is based on its current allowed ROE adjusted for forecasted disallowed costs and expectations regarding the direction and magnitude of movements in interest rates. The terminal growth rate is based on a combination of historical and forecasted statistics for real gross domestic product and personal income for each utility service area.

We used the guideline company method for the market approach. This method uses metrics from similar publicly traded companies in the same industry to determine how much a knowledgeable investor in the marketplace would be willing to pay for an investment in a similar company. We applied multiples derived from these guideline companies to the appropriate operating metric for the utility reporting units to determine indications of fair value.

The underlying assumptions and estimates used in the impairment test are made as of a point in time. Subsequent changes in these assumptions and estimates could change the results of the test.

The fair values of the WPS natural gas utility and Integrys Energy Services reporting units exceeded the carrying values by a substantial amount. Based on these results, these reporting units are not at risk of failing step one of the goodwill impairment test.

The fair values calculated in the first step of the test for MGU, MERC, PGL, and NSG exceeded the carrying values by approximately 6% to 17%. Due to the subjectivity of the assumptions and estimates underlying the impairment analysis, we cannot provide assurance that future analyses will not result in impairments. As a result, we performed a sensitivity analysis on key assumptions for these reporting units. The following table shows the change in each assumption, holding all other inputs constant, that would result in a fair value at or below carrying value, causing the applicable reporting unit to fail step one of the test:

Change in key inputs (in basis points)	MGU	MERC	PGL	NSG
Discount rate	75	150	175	450
Terminal year return on equity	(195)	(310)	(487)	(810)
Terminal year growth rate	(100)	(225)	N/A *	N/A *

* Even with a terminal year growth rate of 0%, assuming all other inputs remained constant, these reporting units would still have passed the first step of the goodwill impairment test.

Accrued Unbilled Revenues

We accrue estimated amounts of revenues for services provided or energy delivered but not yet billed to customers. Estimated unbilled revenues are calculated using a variety of judgments and assumptions related to customer class or contracted rates. Significant changes in these judgments and assumptions could have a material impact on our results of operations. At December 31, 2011 and 2010, our unbilled revenues were $282.1 million and $339.1 million, respectively. The amount of unbilled revenues can vary significantly from period to period as a result of numerous factors, including seasonality, weather, customer usage patterns, commodity prices, and customer mix.

Pension and Other Postretirement Benefits

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

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

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

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

Actuarial Assumption *(Millions, except percentages)*	**Percentage-Point Change in Assumption**	**Impact on Projected Benefit Obligation**	**Impact on 2011 Pension Cost**
Discount rate	(0.5)	$102.0	$8.9
Discount rate	0.5	(93.7)	(8.5)
Rate of return on plan assets	(0.5)	N/A	6.1
Rate of return on plan assets	0.5	N/A	(6.1)

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

Actuarial Assumption *(Millions, except percentages)*	**Percentage-Point Change in Assumption**	**Impact on Postretirement Benefit Obligation**	**Impact on 2011 Postretirement Benefit Cost**
Discount rate	(0.5)	$ 37.3	$2.7
Discount rate	0.5	(34.9)	(2.2)
Health care cost trend rate	(1.0)	(60.9)	(8.4)
Health care cost trend rate	1.0	73.7	10.9
Rate of return on plan assets	(0.5)	N/A	1.3
Rate of return on plan assets	0.5	N/A	(1.3)

The discount rates are selected based on hypothetical bond portfolios consisting of non-callable (or callable with make-whole provisions), non-collateralized, high-quality corporate bonds with maturities between 0 and 30 years. The bonds are generally rated "Aa" with a minimum amount outstanding of $50 million. From the hypothetical bond portfolios, a single rate is determined that equates the market value of the bonds purchased to the discounted value of the plans' expected future benefit payments.

We establish our expected return on asset assumption based on consideration of historical and projected asset class returns, as well as the target allocations of the benefit trust portfolios. The assumed long-term rate of return was 8.25% in 2011, and 8.50% in 2010 and 2009. For 2011, 2010, and 2009, the actual rates of return on pension plan assets, net of fees, were 1.5%, 13.0%, and 22.0%, respectively.

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

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

Regulatory Accounting

Our electric and natural gas utility segments follow the guidance under the Regulated Operations Topic of the FASB ASC. Our financial statements reflect the effects of the ratemaking principles followed by the various jurisdictions regulating these segments. Certain items that would otherwise be immediately recognized as revenues and expenses are deferred as regulatory assets and regulatory liabilities for future recovery or refund to customers, as authorized by our regulators. Future recovery of regulatory assets is not assured, and is generally subject to review by regulators in rate proceedings for matters such as prudence and reasonableness. Management regularly assesses whether these regulatory assets and liabilities are probable of future recovery or refund by considering factors such as changes in the regulatory environment, earnings at the electric and natural gas utility segments, and the status of any pending or potential deregulation legislation. Once approved, the regulatory assets and liabilities are amortized into earnings over the rate recovery period. If recovery or refund of costs is not approved or is no longer deemed probable, these regulatory assets or liabilities are recognized in current period earnings.

The application of the Regulated Operations Topic of the FASB ASC would be discontinued if all or a separable portion of our electric and natural gas utility segment's operations no longer meet the criteria for application. Assets and liabilities recognized as a result of rate regulation would be written off as extraordinary items in income for the period in which the discontinuation occurred. A write-off of all our regulatory assets and regulatory liabilities at December 31, 2011, would result in a 17.9% decrease in total assets and a 5.7% decrease in total liabilities. The two largest regulatory assets at December 31, 2011, related to unrecognized pension and other postretirement benefit costs and environmental remediation costs. A write-off of the unrecognized pension and other postretirement benefit related regulatory asset at December 31, 2011, would result in a 7.3% decrease in total assets. A write-off of the regulatory asset related to environmental remediation costs at December 31, 2011, would result in a 6.3% decrease in total assets. See Note 8, "*Regulatory Assets and Liabilities*," for more information.

Income Tax Provision

We are required to estimate income taxes for each of the jurisdictions in which we operate as part of the process of preparing consolidated financial statements. This process involves estimating current income tax liabilities together with assessing temporary differences resulting from differing treatment of items, such as depreciation, for income tax and accounting purposes. These differences result in deferred income tax assets and liabilities, which are included within our balance sheets. We also assess the likelihood that our deferred income tax assets will be recovered through future taxable income. To the extent we believe that realization is not likely, we establish a valuation allowance, which is offset by an adjustment to the provision for income taxes in the income statements.

Uncertainty associated with the application of tax statutes and regulations and the outcomes of tax audits and appeals requires that judgments and estimates be made in the accrual process and in the calculation of effective tax rates. Only income tax benefits that meet the "more likely than not" recognition threshold may be recognized or continue to be recognized. Unrecognized tax benefits are re-evaluated quarterly and changes are recorded based on new information, including the issuance of relevant guidance by the courts or tax authorities and developments occurring in the examinations of our tax returns.

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

IMPACT OF INFLATION

Our financial statements are prepared in accordance with GAAP. The statements provide a reasonable, objective, and quantifiable statement of financial results, but generally do not evaluate the impact of inflation. To the extent our regulated operations are not recovering the effects of inflation, they will file rate cases as necessary in the various jurisdictions in which they operate. Our nonregulated businesses include inflation in forecasted costs.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risks and Other Significant Risks

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

Commodity Price Risk

Utilities

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

WPS's Wisconsin retail electric operations do not have a one-for-one recovery mechanism for price fluctuations. Instead, a "fuel window" mechanism substantially mitigates this price risk.

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

See Note 1(f), "*Summary of Significant Accounting Policies -- Revenues and Customer Receivables*," for more information.

Integrys Energy Services

Integrys Energy Services seeks to reduce market price risk from its generation and energy supply portfolios through the use of various financial and physical instruments. Additionally, Integrys Energy Services uses volume limits and stop loss limits to limit its exposure to commodity price movements.

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

VaR is a probabilistic approach to quantifying the exposure to market risk. The VaR amount represents an estimate of the potential change in fair value that could occur from changes in market factors, within a given confidence level, if an instrument or portfolio is held for a specified time period. In addition to VaR, Integrys Energy Services employs other risk measurements including mark-to-market valuations, stress testing, and scenario-based testing. In conjunction with the VaR analysis, these other risk measurements provide the risk management analysis for Integrys Energy Services' risk exposure.

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

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

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

(Millions)	**2011**	**2010**
As of December 31	**$0.2**	$0.2
Average for 12 months ended December 31	**0.2**	0.3
High for 12 months ended December 31	**0.3**	0.3
Low for 12 months ended December 31	**0.1**	0.2

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

(Millions)	**2011**	**2010**
As of December 31	**$0.7**	$1.1
Average for 12 months ended December 31	**0.7**	1.4
High for 12 months ended December 31	**1.2**	1.5
Low for 12 months ended December 31	**0.5**	1.1

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

The year-over-year decrease in VaR was driven primarily by reduced business size, as a result of Integrys Energy Services' strategy change.

Interest Rate Risk

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

Due to short-term borrowings, we are exposed to variable interest rates. Based on our variable rate debt outstanding at December 31, 2011, a hypothetical increase in market interest rates of 100 basis points would have increased annual interest expense by $3.3 million. Comparatively, based on the variable rate debt outstanding at December 31, 2010, an increase in interest rates of 100 basis points would have increased annual interest expense by $1.4 million. This sensitivity analysis was performed assuming a constant level of variable rate debt during the period and an immediate increase in interest rates, with no other changes for the remainder of the period.

Equity Return and Principal Preservation Risk

We currently fund liabilities related to employee benefits through various external trust funds. The trust funds are managed by numerous investment managers and hold investments primarily in debt and equity securities. Changes in the market value of these investments can have an impact on the future expenses related to these liabilities. Declines in the equity markets or declines in interest rates may result in increased future costs for the plans and require additional contributions into the plans. We monitor the trust fund portfolio by benchmarking the performance of the investments against certain security indices. Most of the employee benefit costs relate to the regulated utilities. As such, the majority of these costs are recovered in customers' rates, reducing most of the equity return and principal preservation risk on these exposures. Also, the likelihood of an increase in the employee benefit obligations, which the investments must fund, has been partially mitigated as a result of certain employee groups no longer being eligible to participate in, or accumulate benefits in, certain pension and other postretirement benefit plans. Our defined benefit pension plans are closed to all new hires.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

A. MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2011. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. Based on this assessment, management believes that, as of December 31, 2011, our internal control over financial reporting is effective.

Our independent registered public accounting firm has issued an audit report on the effectiveness of our internal control over financial reporting.

B. REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the internal control over financial reporting of Integrys Energy Group, Inc. and subsidiaries (the "Company") as of December 31, 2011, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedules as of and for the year ended December 31, 2011 of the Company and our report dated February 28, 2012 expressed an unqualified opinion on those financial statements and financial statement schedules.

/s/ Deloitte & Touche LLP

Milwaukee, Wisconsin
February 28, 2012

C. CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 (Millions, except per share data)	2011	2010	2009
Utility revenues	$3,294.5	$3,368.5	$3,495.8
Nonregulated revenues	1,414.2	1,834.7	4,004.0
Total revenues	4,708.7	5,203.2	7,499.8
Utility cost of fuel, natural gas, and purchased power	1,635.3	1,685.5	1,919.8
Nonregulated cost of sales	1,281.6	1,619.8	3,701.3
Operating and maintenance expense	1,028.2	1,045.6	1,098.4
Impairment losses on property, plant, and equipment	4.6	43.2	0.7
Restructuring expense	2.0	7.9	43.5
Net (gain) loss on Integrys Energy Services' dispositions related to strategy change	(0.3)	14.1	28.9
Goodwill impairment loss	-	-	291.1
Depreciation and amortization expense	250.1	265.8	230.6
Taxes other than income taxes	98.4	93.2	96.3
Operating income	408.8	428.1	89.2
Miscellaneous income	84.8	91.5	89.0
Interest expense	(128.8)	(147.9)	(164.8)
Other expense	(44.0)	(56.4)	(75.8)
Income before taxes	364.8	371.7	13.4
Provision for income taxes	133.9	148.2	83.7
Net income (loss) from continuing operations	230.9	223.5	(70.3)
Discontinued operations, net of tax	(0.4)	0.2	2.8
Net income (loss)	230.5	223.7	(67.5)
Preferred stock dividends of subsidiary	(3.1)	(3.1)	(3.1)
Noncontrolling interest in subsidiaries	-	0.3	1.0
Net income (loss) attributed to common shareholders	$ 227.4	$ 220.9	$ (69.6)
Average shares of common stock			
Basic	78.6	77.5	76.8
Diluted	79.1	78.0	76.8
Earnings (loss) per common share (basic)			
Net income (loss) from continuing operations	$2.90	$2.85	$(0.95)
Discontinued operations, net of tax	(0.01)	-	0.04
Earnings (loss) per common share (basic)	$2.89	$2.85	$(0.91)
Earnings (loss) per common share (diluted)			
Net income (loss) from continuing operations	$2.88	$2.83	$(0.95)
Discontinued operations, net of tax	(0.01)	-	0.04
Earnings (loss) per common share (diluted)	$2.87	$2.83	$(0.91)
Dividends per common share declared	$2.72	$2.72	$2.72

The accompanying notes to the consolidated financial statements are an integral part of these statements.

D. CONSOLIDATED BALANCE SHEETS

At December 31 (Millions)	2011	2010
Assets		
Cash and cash equivalents	$ 28.1	$ 179.0
Collateral on deposit	50.9	33.3
Accounts receivable and accrued unbilled revenues, net of reserves of $47.1 and $41.9, respectively	737.7	832.1
Inventories	252.3	247.9
Assets from risk management activities	227.2	236.9
Regulatory assets	125.1	117.9
Deferred income taxes	94.2	67.7
Prepaid taxes	209.6	269.9
Other current assets	78.2	65.7
Current assets	1,803.3	2,050.4
Property, plant, and equipment, net of accumulated depreciation of $3,018.7 and $2,900.2, respectively	5,199.1	5,013.4
Regulatory assets	1,658.5	1,495.1
Assets from risk management activities	64.4	89.4
Goodwill	658.4	642.5
Other long-term assets	599.5	526.0
Total assets	$9,983.2	$9,816.8
Liabilities and Equity		
Short-term debt	$ 303.3	$ 10.0
Current portion of long-term debt	250.0	476.9
Accounts payable	426.6	453.0
Liabilities from risk management activities	311.6	289.6
Accrued taxes	70.5	90.2
Regulatory liabilities	67.5	75.7
Other current liabilities	217.2	262.4
Current liabilities	1,646.7	1,657.8
Long-term debt	1,872.0	2,161.6
Deferred income taxes	1,070.7	860.5
Deferred investment tax credits	44.0	45.2
Regulatory liabilities	332.5	316.2
Environmental remediation liabilities	615.1	643.9
Pension and other postretirement benefit obligations	749.3	603.4
Liabilities from risk management activities	102.0	99.7
Asset retirement obligations	397.2	320.9
Other long-term liabilities	141.1	150.6
Long-term liabilities	5,323.9	5,202.0
Commitments and contingencies		
Common stock - $1 par value; 200,000,000 shares authorized; 78,287,906 shares issued; 77,904,935 shares outstanding	78.3	77.8
Additional paid-in capital	2,579.1	2,540.4
Retained earnings	363.6	350.8
Accumulated other comprehensive loss	(42.5)	(44.7)
Shares in deferred compensation trust	(17.1)	(18.5)
Total common shareholders' equity	2,961.4	2,905.8
Preferred stock of subsidiary - $100 par value; 1,000,000 shares authorized; 511,882 shares issued; 510,495 shares outstanding	51.1	51.1
Noncontrolling interest in subsidiaries	0.1	0.1
Total liabilities and equity	$9,983.2	$9,816.8

The accompanying notes to the consolidated financial statements are an integral part of these statements.

E. CONSOLIDATED STATEMENTS OF EQUITY

	Integrys Energy Group Common Shareholders' Equity								
(Millions)	Deferred Compensation Trust and Treasury Stock	Common Stock	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Common Shareholders' Equity	Preferred Stock of Subsidiary	Noncontrolling Interest	Total Equity
Balance at December 31, 2008	$(16.5)	$76.4	$2,487.9	$614.7	$(72.8)	$3,089.7	$51.1	$ -	$3,140.8
Net loss attributed to common shareholders	-	-	-	(69.6)	-	(69.6)	-	(1.0)	(70.6)
Other comprehensive income (loss)									
Cash flow hedges (net of tax of $17.0)	-	-	-	-	31.5	31.5	-	-	31.5
Unrecognized pension and other postretirement costs (net of tax of $3.2)	-	-	-	-	(6.7)	(6.7)	-	-	(6.7)
Available-for-sale securities (net of tax of $0.1)	-	-	-	-	(0.1)	(0.1)	-	-	(0.1)
Foreign currency translation (net of tax of $2.6)	-	-	-	-	4.1	4.1	-	-	4.1
Comprehensive loss						(40.8)			(41.8)
Purchase of deferred compensation shares	(3.1)	-	-	-	-	(3.1)	-	-	(3.1)
Stock based compensation	0.1	-	11.3	-	-	11.4	-	-	11.4
Dividends on common stock	-	-	-	(206.9)	-	(206.9)	-	-	(206.9)
Net contributions from noncontrolling parties	-	-	-	-	-	-	-	0.1	0.1
Other	2.3	-	(1.4)	(1.2)	-	(0.3)	-	-	(0.3)
Balance at December 31, 2009	$(17.2)	$76.4	$2,497.8	$337.0	$(44.0)	$2,850.0	$51.1	$ (0.9)	$2,900.2
Net income attributed to common shareholders	-	-	-	220.9	-	220.9	-	(0.3)	220.6
Other comprehensive income (loss)									
Cash flow hedges (net of tax of $4.7)	-	-	-	-	4.5	4.5	-	-	4.5
Unrecognized pension and other postretirement costs (net of tax of $2.0)	-	-	-	-	(2.8)	(2.8)	-	-	(2.8)
Foreign currency translation (net of tax of $1.5)	-	-	-	-	(2.4)	(2.4)	-	-	(2.4)
Comprehensive income						220.2			219.9
Issuance of common stock	-	1.3	54.5	-	-	55.8	-	-	55.8
Purchase of deferred compensation shares	(1.2)	-	-	-	-	(1.2)	-	-	(1.2)
Stock based compensation	-	-	4.0	-	-	4.0	-	-	4.0
Dividends on common stock	-	-	-	(208.7)	-	(208.7)	-	-	(208.7)
Other	(0.1)	0.1	(15.9)	1.6	-	(14.3)	-	1.3	(13.0)
Balance at December 31, 2010	$(18.5)	$77.8	$2,540.4	$350.8	$(44.7)	$2,905.8	$51.1	$ 0.1	$2,957.0
Net income attributed to common shareholders	-	-	-	227.4	-	227.4	-	0.0	227.4
Other comprehensive income (loss)									
Cash flow hedges (net of tax of $4.8)	-	-	-	-	8.9	8.9	-	-	8.9
Unrecognized pension and other postretirement costs (net of tax of $5.1)	-	-	-	-	(6.7)	(6.7)	-	-	(6.7)
Comprehensive income						229.6			229.6
Issuance of common stock	-	0.5	21.7	-	-	22.2	-	-	22.2
Purchase of deferred compensation shares	(1.0)	-	-	-	-	(1.0)	-	-	(1.0)
Stock based compensation	-	-	7.5	(2.1)	-	5.4	-	-	5.4
Dividends on common stock	-	-	-	(211.8)	-	(211.8)	-	-	(211.8)
Other	2.4	-	9.5	(0.7)	-	11.2	-	-	11.2
Balance at December 31, 2011	$(17.1)	$78.3	$2,579.1	$363.6	$(42.5)	$2,961.4	$51.1	$ 0.1	$3,012.6

The accompanying notes to the consolidated financial statements are an integral part of these statements.

F. CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31 (Millions)	2011	2010	2009
Operating Activities			
Net income (loss)	$ 230.5	$ 223.7	$ (67.5)
Adjustments to reconcile net income (loss) to net cash provided by operating activities			
Discontinued operations, net of tax	0.4	(0.2)	(2.8)
Goodwill impairment loss	-	-	291.1
Impairment losses on property, plant, and equipment	4.6	43.2	0.7
Depreciation and amortization expense	250.1	265.8	230.6
Recoveries and refunds of regulatory assets and liabilities	56.1	28.7	40.8
Net unrealized (gains) losses on nonregulated energy contracts	48.5	(55.8)	104.2
Nonregulated lower of cost or market inventory adjustments	11.6	0.9	44.2
Bad debt expense	35.0	48.0	54.6
Pension and other postretirement expense	60.0	67.6	72.4
Pension and other postretirement contributions	(131.5)	(201.8)	(53.3)
Deferred income taxes and investment tax credits	175.3	234.1	58.3
(Gain) loss on sale of assets	(2.2)	11.4	24.1
Equity income, net of dividends	(14.8)	(14.5)	(16.1)
Other	32.5	33.3	37.7
Changes in working capital			
Collateral on deposit	(17.3)	163.6	45.5
Accounts receivable and accrued unbilled revenues	94.1	97.6	864.8
Inventories	(28.0)	51.1	444.1
Other current assets	46.2	(85.5)	39.6
Accounts payable	(37.4)	(25.8)	(604.7)
Other current liabilities	(91.8)	(160.2)	(2.0)
Net cash provided by operating activities	721.9	725.2	1,606.3
Investing Activities			
Capital expenditures	(311.4)	(258.8)	(444.2)
Proceeds from the sale or disposal of assets	7.6	66.0	44.6
Capital contributions to equity method investments	(37.6)	(6.9)	(34.1)
Acquisition of compressed natural gas fueling companies, net of cash acquired	(42.6)	-	-
Other	(10.8)	-	(7.0)
Net cash used for investing activities	(394.8)	(199.7)	(440.7)
Financing Activities			
Short-term debt, net	303.3	(212.1)	(815.7)
Redemption of notes payable	(10.0)	-	(157.9)
Proceeds from sale of borrowed natural gas	-	21.9	162.0
Purchase of natural gas to repay natural gas loans	-	(6.5)	(445.2)
Issuance of long-term debt	50.0	250.0	230.0
Repayment of long-term debt	(565.8)	(117.2)	(157.8)
Payment of dividends			
Preferred stock of subsidiary	(3.1)	(3.1)	(3.1)
Common stock	(206.4)	(186.1)	(206.9)
Issuance of common stock	4.9	33.2	-
Proceeds from derivative contracts related to divestitures classified as financing activities	-	-	33.9
Payments made on derivative contracts related to divestitures classified as financing activities	(31.9)	(157.8)	-
Other	(19.4)	(13.7)	(17.7)
Net cash used for financing activities	(478.4)	(391.4)	(1,378.4)
Change in cash and cash equivalents - continuing operations	(151.3)	134.1	(212.8)
Change in cash and cash equivalents - discontinued operations			
Net cash provided by investing activities	0.4	0.4	3.2
Net change in cash and cash equivalents	(150.9)	134.5	(209.6)
Cash and cash equivalents at beginning of year	179.0	44.5	254.1
Cash and cash equivalents at end of year	$ 28.1	$ 179.0	$ 44.5

The accompanying notes to the consolidated financial statements are an integral part of these statements.

G. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Operations—We are a holding company whose primary wholly owned subsidiaries at December 31, 2011, included WPS, UPPCO, MGU, MERC, PGL, NSG, IBS, Integrys Energy Services, and ITF. Of these subsidiaries, six are regulated electric and/or natural gas utilities, one, IBS, is a centralized service company, one, Integrys Energy Services, is a nonregulated retail energy supply and services company, and one, ITF, is a nonregulated compressed natural gas fueling business. In addition, we have an approximate 34% interest in ATC.

As used in these notes, the term "financial statements" refers to the consolidated financial statements. This includes the consolidated statements of income, consolidated balance sheets, consolidated statements of equity, and consolidated statements of cash flows, unless otherwise noted.

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

(b) Consolidated Basis of Presentation—The financial statements include our accounts and the accounts of all of our majority owned subsidiaries, after eliminating intercompany transactions and balances. These financial statements also reflect our proportionate interests in certain jointly owned utility facilities. The cost method of accounting is used for investments when we do not have significant influence over the operating and financial policies of the investee. Investments in businesses not controlled by us, but over which we have significant influence regarding the operating and financial policies of the investee, are accounted for using the equity method. For more information on equity method investments, see Note 9, "*Investments in Affiliates, at Equity Method*."

(c) Reclassifications—We reclassified $127.2 million reported in other current assets at December 31, 2010, to prepaid taxes to match the current year presentation on the balance sheet.

(d) Use of Estimates—We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. We make estimates and assumptions that affect assets, liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

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

The following is supplemental disclosure to our statements of cash flows:

(Millions)	2011	2010	2009
Cash paid for interest	**$130.7**	$138.7	$164.8
Cash (received) paid for income taxes	**(80.0)**	(2.2)	19.1

Significant noncash transactions were:

(Millions)	2011	2010	2009
Construction costs funded through accounts payable	**$58.6**	$18.3	$30.4
Equity issued for stock-based compensation plans	**15.8**	3.0	-
Equity issued for reinvested dividends	**5.4**	22.6	-
Intangible assets (customer contracts) received in exchange for risk management assets	-	-	17.0

(f) Revenues and Customer Receivables—Revenues related to the sale of energy are recognized when service is provided or energy is delivered to customers and include estimated amounts for services provided but not billed. At December 31, 2011 and 2010, our unbilled revenues were $282.1 million and $339.1 million, respectively. At December 31, 2011, there were no customers or industries that accounted for more than 10% of our revenues. We present revenue net of pass-through taxes on the income statements.

Our utility subsidiaries have various rate-adjustment mechanisms in place that currently provide for the recovery of prudently incurred electric fuel costs, purchased power costs, and natural gas costs, which allow subsequent adjustments to rates for changes in commodity costs. Other mechanisms also allow recovery for environmental costs, conservation improvement program (CIP) costs, bad debts, and energy conservation and management programs. A summary of significant rate-adjustment mechanisms follows:

- Fuel and purchased power costs are recovered from customers on a one-for-one basis by UPPCO, WPS's wholesale electric operations, and WPS's Michigan retail electric operations.
- WPS's Wisconsin retail electric operations use a "fuel window" mechanism to recover fuel and purchased power costs. Under the fuel window rules effective January 1, 2011, a deferral is required for under or over-collections of actual fuel and purchased power costs that exceed a 2% price variance from the costs included in the rates charged to customers. Under or over-collections deferred in the current year are recovered or refunded in a future rate proceeding.
- The rates for all of our natural gas utilities include one-for-one recovery mechanisms for natural gas commodity costs.
- The rates of PGL and NSG include riders for cost recovery of both environmental cleanup and energy conservation and management program costs.
- MERC's rates include a CIP rider for cost recovery of energy conservation and management program costs as well as recovery of a financial incentive for meeting energy savings goals.
- The rates of PGL, NSG, and MGU include riders for cost recovery or refund of bad debts based on the difference between actual bad debt cost (as defined in the latest rate order) and the amount recovered in rates.
- Decoupling mechanisms were in place at WPS, PGL, NSG, MGU, and UPPCO for 2011. These mechanisms differ state by state and allow utilities to adjust rates going forward to recover or refund all or a portion of the differences between actual and authorized margins.

Revenues are also impacted by other accounting policies related to PGL's natural gas hub and our utility subsidiaries' participation in the MISO market. Amounts collected from PGL's wholesale customers that use the natural gas hub are credited to natural gas costs, resulting in a reduction to retail customers' charges for natural gas and services. WPS and UPPCO both sell and purchase power in the MISO market. If WPS or UPPCO is a net seller in a particular hour, the net amount is reported as revenue. If WPS or UPPCO is a net purchaser in a particular hour, the net amount is recorded as utility cost of fuel, natural gas, and purchased power on the income statements.

ITF accounts for revenues from construction management projects with the percentage of completion method. Revenue is measured by the percentage of costs incurred to date to the estimated total costs for each contract. This method is used because management considers total costs to be the best available measure of progress on these contracts.

See Note 1(h), "*Risk Management Activities*," for more information on the classification of certain unrealized gains and losses on derivative instruments in revenues.

(g) **Inventories**—Inventories consist of natural gas in storage, liquid propane, and fossil fuels, including coal. Average cost is used to value fossil fuels, liquid propane, and natural gas in storage for the regulated utilities, excluding PGL and NSG. PGL and NSG price natural gas storage injections at the calendar year average of the costs of natural gas supply purchased. Withdrawals from storage are priced on the LIFO cost method. Inventories stated on a LIFO basis represented approximately 37% of total inventories at December 31, 2011, and 34% of total inventories at December 31, 2010. The estimated replacement cost of natural gas in inventory at December 31, 2011, and December 31, 2010, exceeded the LIFO cost by approximately $65.7 million and $136.7 million, respectively. In calculating these replacement amounts, PGL and NSG used a Chicago city-gate natural gas price per dekatherm of $3.06 at December 31, 2011, and $4.42 at December 31, 2010.

Inventories at Integrys Energy Services are valued at the lower of cost or market. Integrys Energy Services recorded net write-downs of $11.6 million, $0.9 million, and $44.2 million in 2011, 2010, and 2009, respectively.

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

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

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

Derivative accounting rules provide the option to present certain asset and liability derivative positions net on the balance sheets and to net the related cash collateral against these net derivative positions. We elected not to net these items. On the balance sheets, cash collateral provided to others is shown separately as collateral on deposit, and cash collateral received from others is reflected in other current liabilities.

We have risk management contracts with various counterparties. We monitor credit exposure levels and the financial condition of our counterparties on a continuous basis to minimize credit risk. At December 31, 2011, we did not have risk management contracts with any one counterparty or industry that accounted for more than 10% of our total credit risk exposure.

(i) Emission Allowances—Integrys Energy Services accounts for emission allowances as intangible assets, with cash inflows and outflows related to purchases and sales of emission allowances recorded as investing activities in the Statements of Cash Flows. The utilities account for emission allowances as inventory at average cost by vintage year. Charges to income result when allowances are used in operating the utilities' generation plants. Gains on sales of allowances at the utilities are returned to ratepayers. Losses on emission allowances at the utilities are included in the costs subject to the fuel window rules.

(j) Property, Plant, and Equipment—Utility plant is stated at original cost, including any associated AFUDC and asset retirement costs. The costs of renewals and betterments of units of property (as distinguished from minor items of property) are capitalized as additions to the utility plant accounts. Except for land, no gains or losses are recognized in connection with ordinary retirements of utility property units. The utilities charge the cost of units of property retired, sold, or otherwise disposed of, less salvage value, to accumulated depreciation. In addition, the utilities record a regulatory liability for cost of removal accruals, which are included in rates. Actual removal costs are charged against the regulatory liability as incurred. Maintenance, repair, replacement, and renewal costs associated with items not qualifying as units of property are considered operating expenses. We record straight-line depreciation expense over the estimated useful life of utility property using depreciation rates as approved by the applicable regulators. Annual utility composite depreciation rates are shown below. WPS received approval from the PSCW for lower depreciation rates, effective January 1, 2011.

Annual Utility Composite Depreciation Rates	2011	2010	2009
WPS – Electric	**2.88%**	3.05%	3.04%
WPS – Natural gas	**2.22%**	3.28%	3.30%
UPPCO	**3.33%**	3.18%	3.05%
MGU	**2.73%**	3.55%	2.66%
MERC	**3.10%**	3.08%	3.10%
PGL	**3.18%**	3.10%	2.29%
NSG	**2.42%**	2.35%	1.66%

The majority of nonregulated plant is stated at cost, net of impairments recorded, and includes capitalized interest. The costs of renewals, betterments, and major overhauls are capitalized as additions to plant. Nonregulated plant acquired as a result of mergers and acquisitions have been recorded at fair value. The gains or losses associated with ordinary retirements are recorded in the period of retirement. Maintenance, repair, and minor replacement costs are expensed as incurred. Depreciation is computed for the majority of the nonregulated subsidiaries' assets using the straight-line method over the assets' useful lives.

We capitalize certain costs related to software developed or obtained for internal use and amortize those costs to operating expense over the estimated useful life of the related software, which ranges from 3 to 15 years. If software is retired prior to being fully amortized, the difference is recorded as a loss on the income statements.

See Note 6, "*Property, Plant, and Equipment*," for details regarding our property, plant, and equipment balances.

(k) Capitalized Interest and AFUDC—Our nonregulated subsidiaries capitalize interest for construction projects; however, interest capitalized was not significant during 2011, 2010, and 2009. Our utilities capitalize the cost of funds used for construction using a calculation that includes both internal equity and external debt components, as required by regulatory accounting. The internal equity component of capitalized AFUDC is accounted for as other income, and the external debt component is accounted for as a decrease to interest expense.

Approximately 50% of WPS's retail jurisdictional construction work in progress expenditures are subject to the AFUDC calculation. For 2011, WPS's average AFUDC retail rate was 7.71%, and its average AFUDC wholesale rate was 4.16%. WPS's allowance for equity funds used during construction for 2011, 2010, and 2009 was $0.6 million, $0.7 million, and $5.1 million, respectively. WPS's allowance for borrowed funds used during construction for 2011, 2010, and 2009 was $0.2 million, $0.3 million, and $2.0 million, respectively.

The AFUDC calculation for the other utilities and IBS is determined by the respective state commissions, each with specific requirements. Based on these requirements, the other utilities and IBS did not record significant AFUDC for 2011, 2010, or 2009.

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

(m) **Asset Impairment**—Goodwill and other intangible assets with indefinite lives are not amortized, but are subject to an annual impairment test. Other long-lived assets require an impairment review when events or circumstances indicate that the carrying amount may not be recoverable. We base our evaluation of other long-lived assets on the presence of impairment indicators such as the future economic benefit of the assets, any historical or future profitability measurements, and other external market conditions or factors. See Note 6, "*Property, Plant, and Equipment*," for a discussion of recent impairments related to other long-lived assets.

Our reporting units containing goodwill perform annual goodwill impairment tests during the second quarter of each year, and interim impairment tests when impairment indicators are present. The carrying amount of the reporting unit's goodwill is considered not recoverable if it exceeds the reporting unit's fair value. An impairment loss is recorded for the excess of the carrying value of the goodwill over its implied fair value. For more information on our goodwill and other intangible assets, see Note 10, "*Goodwill and Other Intangible Assets*."

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

The carrying value of assets held for sale is not recoverable if it exceeds the fair value less estimated costs to sell the asset. An impairment loss is recorded for the excess of the asset's carrying value over the fair value less estimated costs to sell.

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

Integrys Energy Services evaluates emission allowances for impairment by comparing the expected undiscounted future cash flows to the carrying amount. When allowances are expected to be used for generation, the allowances are grouped with the related power plant in the impairment evaluation.

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

(o) **Asset Retirement Obligations**—We recognize legal obligations at fair value associated with the retirement of tangible long-lived assets that result from the acquisition, construction or development, and/or normal operation of the assets. A liability is recorded for these obligations as long as the fair value can be reasonably estimated, even if the timing or method of settling the obligation is unknown. The asset retirement obligations are accreted using a credit-adjusted risk-free interest rate commensurate with the expected settlement dates of the asset retirement obligations; this rate is determined at the date the obligation is incurred. The associated retirement costs are capitalized as part of the related long-lived assets and are depreciated over the useful lives of the assets. Subsequent changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows are recognized as an increase or a decrease in the carrying amount of the liability and the associated retirement cost. See Note 14, "*Asset Retirement Obligations*," for more information.

(p) **Income Taxes**—We file a consolidated United States income tax return that includes domestic subsidiaries of which our ownership is 80% or more. We and our consolidated subsidiaries are parties to a federal and state tax allocation arrangement under which each entity determines its provision for income taxes on a stand-alone basis. In several states, combined or consolidated filings are required for certain subsidiaries doing business in that state. The tax allocation arrangement equitably allocates the state taxes associated with these combined or consolidated filings.

Deferred income taxes have been recorded to recognize the expected future tax consequences of events that have been included in the financial statements by using currently enacted tax rates for the differences between the income tax basis of assets and liabilities and the basis reported in the financial statements. We record valuation allowances for deferred income tax assets when it is uncertain if the benefit will be realized in the future. Our regulated utilities defer certain adjustments made to income taxes that will impact future rates and record regulatory assets or liabilities related to these adjustments.

We use the deferral method of accounting for investment tax credits (ITCs). Under this method, we record the ITCs as deferred credits and amortize such credits as a reduction to the provision for income taxes over the life of the asset that generated the ITCs. Production tax credits generally reduce the provision for income taxes in the year that electricity from the qualifying facility is generated and sold. Investment tax credits and production tax credits that do not reduce income taxes payable for the current year are eligible for carryover and recognized as a deferred income tax asset. A valuation allowance is established unless it is more likely than not that the credits will be realized during the carryforward period.

We report interest and penalties accrued related to income taxes as a component of provision for income taxes in the income statements, as well as regulatory assets or regulatory liabilities on the balance sheets.

For more information regarding accounting for income taxes, see Note 15, "*Income Taxes.*"

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

(r) Employee Benefits —The costs of pension and other postretirement benefits are expensed over the periods during which employees render service. Our transition obligation related to other postretirement benefit plans that existed prior to the PELLC merger is being recognized over a 20-year period beginning in 1993. In computing the expected return on plan assets, we use a market-related value of plan assets. Changes in realized and unrealized investment gains and losses are recognized over the subsequent five years for plans sponsored by WPS, while differences between actual investment returns and the expected return on plan assets are recognized over a five-year period for pension plans sponsored by IBS and PELLC. The benefit costs associated with employee benefit plans are allocated among our subsidiaries based on employees' time reporting and actuarial calculations, as applicable. Our regulators allow recovery in rates for the regulated utilities' net periodic benefit cost calculated under GAAP.

We recognize the funded status of defined benefit postretirement plans on the balance sheet, and recognize changes in the plans' funded status in the year in which the changes occur. Our nonregulated segments record changes in the funded status in other comprehensive income, and the regulated utilities record these changes in regulatory asset or liability accounts.

For additional information on our employee benefits, see Note 18, "*Employee Benefit Plans.*"

(s) Fair Value—A fair value measurement is required to reflect the assumptions market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and the risks inherent in the inputs to the model. Transaction costs should not be considered in the determination of fair value.

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

Fair value accounting rules provide a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy are defined as follows:

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

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

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs.

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

We determine fair value using a market-based approach that uses observable market inputs where available, and internally developed inputs where observable market data is not readily available. For the unobservable inputs, consideration is given to the assumptions that market participants would use in valuing the asset or liability. These factors include not only the credit standing of the counterparties involved, but also the impact of our nonperformance risk on our liabilities.

When possible, we base the valuations of our 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 the use of historically settled data or correlations to other locations.

We recognize transfers between the levels of the fair value hierarchy at the value as of the end of the reporting period.

See Note 23, "*Fair Value*," for additional information.

(t) New Accounting Pronouncements—ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS)," was issued in May 2011. The amendments change the wording used to describe the requirements for measuring fair value and for disclosing information about fair value measurements. The amendments also clarify the intent concerning the application of existing fair value measurement requirements. This guidance is effective for our reporting period ending March 31, 2012. Management is currently evaluating the impact that the adoption of this standard will have on our financial statements.

ASU 2011-05, "Presentation of Comprehensive Income," was issued in June 2011. The guidance requires that the total of comprehensive income, the components of net income, and the components of OCI be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The FASB has deferred the requirement regarding the presentation of reclassification adjustments between OCI and net income on the face of the financial statements. This guidance is effective for our reporting period ending March 31, 2012, and is expected to change the format of our financial statements.

ASU 2011-08, "Testing Goodwill for Impairment," was issued in September 2011. The amendments give companies an option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If a company concludes that this is the case, the quantitative impairment test is required. Otherwise, a company can bypass the quantitative impairment test. This guidance is effective for our reporting period ending March 31, 2012, and is not expected to have a significant impact on our financial statements.

ASU 2011-11, "Disclosures about Offsetting Assets and Liabilities," was issued in December 2011. The guidance requires enhanced disclosures about offsetting and related arrangements. This guidance is effective for our reporting period ending March 31, 2013. Management is currently evaluating the impact that the adoption of this standard will have on our financial statements.

NOTE 2—RISK MANAGEMENT ACTIVITIES

The following tables show our assets and liabilities from risk management activities:

(Millions)	Balance Sheet Presentation *	December 31, 2011 Assets from Risk Management Activities	Liabilities from Risk Management Activities
Utility Segments			
Non-hedge derivatives			
Natural gas contracts	Current	$ 9.1	$ 35.4
Natural gas contracts	Long-term	0.1	8.2
Financial transmission rights (FTRs)	Current	2.3	0.1
Petroleum product contracts	Current	0.1	-
Coal contract	Current	-	2.5
Coal contract	Long-term	-	4.4
Cash flow hedges			
Natural gas contracts	Current	-	0.9
Natural gas contracts	Long-term	-	0.2
Nonregulated Segments			
Non-hedge derivatives			
Natural gas contracts	Current	121.6	120.5
Natural gas contracts	Long-term	41.9	40.5
Electric contracts	Current	93.9	152.0
Electric contracts	Long-term	22.4	48.7
Foreign exchange contracts	Current	0.2	0.2
	Current	227.2	311.6
	Long-term	64.4	102.0
Total		$291.6	$413.6

* All derivatives are recognized on the balance sheet at their fair value unless they qualify for the normal purchases and sales exception. We continually assess our contracts designated as normal and will discontinue the treatment of these contracts as normal if the required criteria are no longer met. We classify assets and liabilities from risk management activities as current or long-term based on the maturities of the underlying contracts.

(Millions)	Balance Sheet Presentation *	December 31, 2010 Assets from Risk Management Activities	Liabilities from Risk Management Activities
Utility Segments			
Non-hedge derivatives			
Natural gas contracts	Current	$ 2.2	$ 23.6
Natural gas contracts	Long-term	1.6	1.4
FTRs	Current	3.1	0.2
Petroleum product contracts	Current	0.6	-
Coal contract	Current	-	1.2
Coal contract	Long-term	3.7	-
Cash flow hedges			
Natural gas contracts	Current	-	1.0
Nonregulated Segments			
Non-hedge derivatives			
Natural gas contracts	Current	132.0	113.8
Natural gas contracts	Long-term	62.3	57.7
Electric contracts	Current	85.7	122.0
Electric contracts	Long-term	16.5	30.3
Foreign exchange contracts	Current	1.2	1.2
Foreign exchange contracts	Long-term	0.3	0.3
Fair value hedges			
Interest rate swaps	Current	0.9	-
Cash flow hedges			
Natural gas contracts	Current	1.6	9.2
Natural gas contracts	Long-term	0.1	0.9
Electric contracts	Current	9.6	17.4
Electric contracts	Long-term	4.9	9.1
	Current	236.9	289.6
	Long-term	89.4	99.7
Total		$326.3	$389.3

* All derivatives are recognized on the balance sheet at their fair value unless they qualify for the normal purchases and sales exception. We continually assess our contracts designated as normal and will discontinue the treatment of these contracts as normal if the required criteria are no longer met. We classify assets and liabilities from risk management activities as current or long-term based on the maturities of the underlying contracts.

The following table shows our cash collateral positions:

(Millions)	December 31, 2011	December 31, 2010
Cash collateral provided to others	**$50.9**	$33.3
Cash collateral received from others *	**2.3**	4.5

*Reflected in other current liabilities on the Balance Sheets.

Certain of our derivative and nonderivative commodity instruments contain provisions that could require "adequate assurance" in the event of a material change in our creditworthiness, or the posting of additional collateral for instruments in net liability positions, if triggered by a decrease in credit ratings. The following table shows the aggregate fair value of all derivative instruments with specific credit risk related contingent features that were in a liability position:

(Millions)	December 31, 2011	December 31, 2010
Integrys Energy Services	**$193.8**	$219.5
Utility segments	**39.1**	22.1

If all of the credit risk related contingent features contained in commodity instruments (including derivatives, nonderivatives, normal purchase and normal sales contracts, and applicable payables and receivables) had been triggered, our collateral requirement would have been as follows:

(Millions)	December 31, 2011	December 31, 2010
Collateral that would have been required:		
Integrys Energy Services	$272.3	$295.7
Utility segments	28.7	14.1
Collateral already satisfied:		
Integrys Energy Services – Letters of credit	11.0	56.9
Collateral remaining:		
Integrys Energy Services	261.3	238.8
Utility segments	28.7	14.1

Utility Segments

Non-Hedge Derivatives

Utility derivatives include natural gas purchase contracts, a coal purchase contract, financial derivative contracts (futures, options, and swaps), and FTRs used to manage electric transmission congestion costs. Both the electric and natural gas utility segments use futures, options, and swaps to manage the risks associated with the market price volatility of natural gas supply costs, and the costs of gasoline and diesel fuel used by utility vehicles. The electric utility segment also uses oil futures and options to manage price risk related to coal transportation.

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

	December 31, 2011		December 31, 2010	
	Purchases	Other Transactions	Purchases	Other Transactions
Natural gas (millions of therms)	1,122.7	N/A	979.9	N/A
FTRs (millions of kilowatt-hours)	N/A	5,077.5	N/A	5,882.5
Petroleum products (barrels)	46,872.0	N/A	71,827.0	N/A
Coal contract (millions of tons)	4.1	N/A	4.9	N/A

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

(Millions)	Financial Statement Presentation	2011	2010
Natural gas contracts	Balance Sheet – Regulatory assets (current)	$(11.3)	$(1.7)
Natural gas contracts	Balance Sheet – Regulatory assets (long-term)	(7.6)	0.1
Natural gas contracts	Balance Sheet – Regulatory liabilities (current)	8.4	-
FTRs	Balance Sheet – Regulatory assets (current)	(0.4)	1.0
FTRs	Balance Sheet – Regulatory liabilities (current)	(1.3)	(2.1)
Petroleum product contracts	Balance Sheet – Regulatory assets (current)	(0.1)	-
Petroleum product contracts	Balance Sheet – Regulatory liabilities (current)	-	0.1
Petroleum product contracts	Income Statement – Operating and maintenance expense	(0.1)	0.1
Coal contract	Balance Sheet – Regulatory assets (current)	(1.3)	(1.2)
Coal contract	Balance Sheet – Regulatory assets (long-term)	(4.4)	-
Coal contract	Balance Sheet – Regulatory liabilities (long-term)	(3.7)	3.7

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

Cash Flow Hedges

PGL uses natural gas contracts designated as cash flow hedges to hedge changes in the price of natural gas used to support operations. The cost of natural gas used to support operations is not a component of the natural gas costs recovered from customers on a one-for-one basis. These contracts extend through July 2013. PGL had the following notional volumes of outstanding contracts that were designated as cash flow hedges:

	Purchases	
	December 31, 2011	December 31, 2010
Natural gas (millions of therms)	8.1	5.4

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

Unrealized Loss Recognized in OCI on Derivative Instruments (Effective Portion)			
(Millions)	**2011**	**2010**	**2009**
Natural gas contracts	**$(1.3)**	$(1.6)	$(1.4)

Loss Reclassified from Accumulated OCI into Income (Effective Portion)				
(Millions)	**Income Statement Presentation**	**2011**	**2010**	**2009**
Settled natural gas contracts	Operating and maintenance expense	**$(1.2)**	$(0.9)	$(2.6)

No amounts were reclassified from accumulated OCI into earnings as a result of the discontinuance of cash flow hedge accounting related to these natural gas contracts during 2011, 2010, and 2009. Cash flow hedge ineffectiveness related to these natural gas contracts also was not significant during 2011, 2010, and 2009. When testing for effectiveness, no portion of these derivative instruments was excluded. In the next 12 months, an insignificant loss is expected to be recognized in earnings as the hedged transactions occur.

Nonregulated Segments

Non-Hedge Derivatives

Integrys Energy Services enters into derivative contracts such as futures, forwards, options, and swaps that are not designated as accounting hedges under GAAP. These contracts are used to manage commodity price risk primarily associated with customer-related contracts.

As of July 1, 2011, Integrys Energy Services discontinued the use of cash flow hedge accounting. At December 31, 2011, the amount deferred in accumulated OCI related to cash flow hedges at Integrys Energy Services was a pre-tax loss of $9.9 million. This amount relates to natural gas futures, forwards, and swaps that extend through April 2014, and electric futures, forwards, and swaps that extend through May 2017. This amount will be recognized in earnings as the forecasted transactions occur, or if it becomes probable that the forecasted transactions will not occur.

In the next 12 months, pre-tax losses of $2.0 million and $4.3 million related to the discontinued cash flow hedges of natural gas contracts and electric contracts, respectively, are expected to be recognized in earnings as the forecasted transactions occur. These amounts are expected to be offset by the settlement of the related nonderivative contracts.

Integrys Energy Services had the following notional volumes of outstanding non-hedge derivative contracts:

	December 31, 2011		December 31, 2010	
(Millions)	**Purchases**	**Sales**	**Purchases**	**Sales**
Commodity contracts				
Natural gas (therms)	**959.2**	**797.1**	940.6	1,048.4
Electric (kilowatt-hours)	**34,405.7**	**20,374.0**	22,149.4	19,707.0
Foreign exchange contracts (Canadian dollars)	**4.2**	**4.2**	15.5	15.5

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

(Millions)	Income Statement Presentation	2011	2010
Natural gas contracts	Nonregulated revenue	$ 14.0	$ 30.9
Natural gas contracts	Nonregulated revenue (reclassified from accumulated OCI)	(2.3) *	(1.6) *
Electric contracts	Nonregulated revenue	(79.0)	(92.7)
Electric contracts	Nonregulated revenue (reclassified from accumulated OCI)	(1.7) *	(3.7) *
Interest rate swaps	Interest expense	-	0.4
Total		$(69.0)	$(66.7)

* Represents amounts reclassified from accumulated OCI related to cash flow hedges that were dedesignated in the current and/or prior periods.

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

* Represents amounts reclassified from accumulated OCI related to cash flow hedges that were dedesignated and retained in accumulated OCI in the current and/or prior periods.

Fair Value Hedges

At PELLC, an interest rate swap designated as a fair value hedge was used to hedge changes in the fair value of $50.0 million of the $325.0 million Series A 6.9% notes. The interest rate swap and the notes were settled in January 2011. The changes in the fair value of this hedge were recognized in earnings, as were the changes in fair value of the hedged item. Unrealized gains (losses) related to the fair value hedge and the related hedged item are shown in the table below:

(Millions)	Income Statement Presentation	2011	2010	2009
Interest rate swap	Interest expense	$ -	$(1.7)	$(0.6)
Debt hedged by swap	Interest expense	-	1.7	0.6
Total		$ -	$ -	$ -

Fair value hedge ineffectiveness recorded in interest expense on the Statements of Income was not significant for 2011, 2010, and 2009. No amounts were excluded from effectiveness testing related to the interest rate swap during 2011, 2010, and 2009.

Cash Flow Hedges

Prior to July 1, 2011, Integrys Energy Services designated derivative contracts such as futures, forwards, and swaps as accounting hedges under GAAP. These contracts are used to manage commodity price risk associated with customer-related contracts.

In addition, we entered into interest rate swaps that were designated as cash flow hedges to hedge the variability in forecasted interest payments on debt issuance. The swaps were terminated when the related debt was issued.

Integrys Energy Services had the following notional volumes of outstanding contracts that were designated as cash flow hedges:

	December 31, 2011		December 31, 2010	
(Millions)	Purchases	Sales	Purchases	Sales
Commodity contracts				
Natural gas (therms)	-	-	265.6	-
Electric (kilowatt-hours)	-	-	11,569.0	29.8

The tables below show the amounts related to cash flow hedges recorded in OCI and in earnings:

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

(Millions)	2011	2010
Natural gas contracts	**$(2.3)**	$(15.2)
Electric contracts	**3.8**	(13.6)
Interest rate swaps	**-**	(6.0)
Total	**$1.5**	$(34.8)

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

(Millions)	2009
Commodity contracts	$(60.0)
Interest rate swaps	3.2
Total	$(56.8)

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

(Millions)	Income Statement Presentation	2011	2010
Settled/Realized			
Natural gas contracts	Nonregulated revenue	**$(9.3)**	$(16.4)
Electric contracts	Nonregulated revenue	**4.2**	(21.6)
Interest rate swaps	Interest expense	**(1.1)**	0.2
Hedge Designation Discontinued			
Natural gas contracts	Nonregulated revenue	**(0.3)**	0.2
Electric contracts	Nonregulated revenue	**-**	(9.9)
Interest rate swaps	Interest expense	**(0.2)**	-
Total		**$(6.7)**	$(47.5)

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

(Millions)	Income Statement Presentation	2009
Settled/Realized		
Commodity contracts	Nonregulated revenue	$(107.3)
Interest rate swaps	Interest expense	1.2
Hedge Designation Discontinued		
Commodity contracts	Nonregulated revenue	2.7
Total		$(103.4)

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

(Millions)	Income Statement Presentation	2011	2010
Natural gas contracts	Nonregulated revenue	**$0.3**	$(1.1)
Electric contracts	Nonregulated revenue	**(0.3)**	(0.5)
Total		**$ -**	$(1.6)

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

(Millions)	Income Statement Presentation	2009
Commodity contracts	Nonregulated revenue	$(1.1)

NOTE 3—RESTRUCTURING EXPENSE

Reductions in Workforce

In an effort to remove costs from our operations, we developed a plan at the end of 2009 that included reductions in our workforce. In connection with this plan, employee-related and consulting costs were included in the restructuring expense line item on the Statements of Income. The restructuring costs were distributed across our segments as follows:

(Millions)	2011	2010	2009
Electric utility	$0.2	$(0.3)	$ 8.6
Natural gas utility	-	(0.2)	6.9
Integrys Energy Services	-	-	1.7
Holding company and other	-	0.1	0.8
Total restructuring expense	**$0.2**	$(0.4)	$18.0

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

(Millions)	2011	2010
Accrued restructuring costs at beginning of period	**$0.2**	$18.0
Add: Adjustments to accrual during the period	**-** *	(0.1) *
Deduct: Cash payments	**0.2**	17.7
Accrued restructuring costs at end of period	**$ -**	$ 0.2

* In 2010, restructuring costs of $0.3 million were billed to certain companies in accordance with provisions in the operating agreements with these companies that allow us to recover a portion of our administrative and general expenses. In 2011, the amounts previously billed to these companies were adjusted and reduced by $0.2 million.

We do not expect to recognize any additional restructuring costs associated with this plan in future periods.

Integrys Energy Services Strategy Change

As part of our decision to focus Integrys Energy Services on selected retail electric and natural gas markets in the northeast quadrant of the United States and investments in energy assets with renewable attributes, the following restructuring costs were expensed:

(Millions)	2011	2010	2009
Employee-related costs	**$(0.1)**	$1.1	$10.1
Professional fees	-	6.4	9.2
Software write-offs	-	-	5.3
Accelerated lease costs and depreciation	**1.9**	0.4	0.6
Miscellaneous	-	0.4	0.3
Total restructuring expense	**$ 1.8**	$8.3	$25.5

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

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

(Millions)	2011	2010
Accrued employee-related costs at beginning of period	**$0.3**	$8.2
Add: Employee-related costs expensed	**(0.1)**	1.1
Deduct: Cash payments	**0.2**	9.0
Accrued employee-related costs at end of period	**$ -**	$0.3

We do not expect to recognize any additional restructuring costs associated with the Integrys Energy Services strategy change.

NOTE 4—ACQUISITION

On September 1, 2011, we acquired two compressed natural gas fueling businesses through our newly formed, indirect wholly owned subsidiary, ITF. The total consideration paid for the acquisition of Trillium USA (Trillium) and Pinnacle CNG Systems (Pinnacle) was $49.6 million. This amount is subject to post-closing working capital adjustments. The total cash payment for this transaction was $42.6 million, which was net of cash acquired of approximately $7 million.

Trillium and Pinnacle design, build, maintain, own and/or operate compressed natural gas fueling stations in multiple states. In addition, Pinnacle manufactures and sells a patented method to pressurize compressed natural gas.

See Note 10, "*Goodwill and Other Intangible Assets*," for more information related to this acquisition.

NOTE 5—DISPOSITIONS

Integrys Energy Services Strategy Change

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

Sale of Integrys Energy Services of Texas, LP

In June 2010, Integrys Energy Services sold its Texas retail electric marketing business. The pre-tax gain on the sale of Integrys Energy Services of Texas, LP was $25.5 million and was reported as a component of net (gain) loss on Integrys Energy Services' dispositions related to strategy change on the income statement.

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

(Millions)	
Current assets from risk management activities	$14.0
Other current assets	2.2
Long-term assets from risk management activities	13.8
Other long-term assets	1.9
Total assets	$31.9
Current liabilities from risk management activities	$35.2
Long-term liabilities from risk management activities	27.3
Total liabilities	$62.5

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

Sale of Canadian Natural Gas and Wholesale Electric Marketing and Trading Portfolio

The majority of Integrys Energy Services' Canadian natural gas and electric power portfolio was sold in September 2009, including a natural gas storage contract. In conjunction with the sale, Integrys Energy Services entered into derivative contracts with the buyer of the portfolio to reestablish the economic hedges for the retained United States retail business, at the same prices and other terms originally executed through Integrys Energy Services' Canadian natural gas and electric power portfolio. In May 2010, Integrys Energy Services completed the sale of its remaining Canadian wholesale electric marketing and trading portfolio. The pre-tax losses on the sales in both 2010 and 2009 were $0.4 million and were reported as a component of net (gain) loss on Integrys Energy Services' dispositions related to strategy change in the income statement.

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

(Millions)	
Current assets from risk management activities	$13.8
Long-term assets from risk management activities	10.5
Total assets	$24.3
Current liabilities from risk management activities	$15.2
Long-term liabilities from risk management activities	9.5
Total liabilities	$24.7

Sale of Renewable Energy Certificates Portfolio

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

Sale of United States Wholesale Electric Marketing and Trading Business

In December 2009, Integrys Energy Services entered into a definitive agreement to sell substantially all of its United States wholesale electric marketing and trading business. Effective February 1, 2010, Integrys Energy Services transferred substantially all of the market risk associated with this business by entering into trades with the buyer that mirrored Integrys Energy Services' underlying wholesale electric contracts. In March 2010, Integrys Energy Services closed on the sale and transferred title to the majority of the underlying commodity contracts, upon which time the corresponding mirror transactions terminated. As of December 31, 2010, a vast majority of the commodity contracts had been terminated, with the remaining to be settled through the normal course of business, at which time the corresponding mirror transactions will terminate.

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

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

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

In conjunction with the sale, Integrys Energy Services entered into derivative contracts with the buyer to reestablish the economic hedges for the retained United States retail electric business, with the same prices and terms originally executed through Integrys Energy Services' United States wholesale electric marketing and trading business. Integrys Energy Services will retain counterparty default risk with approximately 50% of the counterparties to the commodity contracts novated, of which the majority will have expired by the end of the first quarter of 2012.

Integrys Energy Services closed on the sale of its only remaining significant wholesale electric commodity contract with another buyer in March 2010.

The pre-tax loss on the sale of the United States wholesale electric marketing and trading business and the remaining commodity contract, net of the gain resulting from the fair value adjustment for the default risk, was $55.7 million in 2010. The 2011 gain due to the change in the carrying value of the default risk was insignificant, as the majority of these contracts have ended as of December 31, 2011. The pre-tax gains and losses for both years were reported as a component of net (gain) loss on Integrys Energy Services' dispositions related to strategy change in the income statement.

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

In January 2010, Integrys Energy Services closed on the sale of two of its power generation businesses, which owned generation assets in New Brunswick, Canada and Northern Maine, and subsequently closed on the sale of the associated retail electric contracts and standard offer service contracts in Northern Maine in February 2010. In conjunction with the sale, Integrys Energy Services entered into derivative contracts with the buyer of the Northern Maine retail electric sales contracts to offset the retained economic hedges associated with the customer contracts sold. The proceeds from the sale of the generation companies and associated retail electric contracts were $38.5 million. The pre-tax gain on the sales was $15.7 million and was reported as a component of net (gain) loss on Integrys Energy Services' dispositions related to strategy change in the income statement.

The carrying values of the major classes of assets and liabilities included in the sales as of the multiple 2010 closing dates were as follows:

(Millions)	
Inventories	$ 0.1
Property, plant, and equipment, net	25.1
Other long-term assets	1.3
Total assets	$26.5
Other current liabilities	$ 0.1
Asset retirement obligations	0.3
Total liabilities	$ 0.4

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

In October 2009, Integrys Energy Services entered into definitive agreements to sell the majority of its United States wholesale natural gas marketing and trading business in a two-part transaction. In December 2009, Integrys Energy Services closed the first part of the transaction by selling substantially all of its United States wholesale natural gas marketing and trading business. The second part of the transaction included the sale of its remaining natural gas storage and related transportation contracts through multiple transactions which closed during the first half of 2010. In January 2010, the buyer exercised its option to purchase these wholesale natural gas storage and related transportation contracts. The carrying value of inventories included in the sales was $1.8 million as of the closing date.

The pre-tax losses on the sale of the United States wholesale natural gas marketing and trading business and natural gas storage and related transportation contracts as of 2010 and 2009 was $2.0 million and $28.5 million, respectively, and were reported as a component of net (gain) loss on Integrys Energy Services' dispositions related to strategy change in the income statement.

Discontinued Operations Resulting from Integrys Energy Services' Strategy Change

Energy Management Consulting Business

During 2011, Integrys Energy Services recorded a $0.1 million after-tax gain in discontinued operations when contingent payments were earned related to the sale of its energy management consulting business.

During 2010, Integrys Energy Services recorded a $0.2 million after-tax gain in discontinued operations when contingent payments were earned related to the sale of its energy management consulting business.

During 2009, Integrys Energy Services completed the sale of its energy management consulting business and received proceeds of $4.7 million. This business provided consulting services relating to long-term strategies for managing energy costs for its customers. The historical results of this business were not significant. The gain on the sale of this business reported in discontinued operations during the third quarter of 2009 was $3.9 million ($2.4 million after tax).

Other Discontinued Operations

Peoples Energy Production Company

During 2011, we recorded a $0.5 million after-tax net loss in discontinued operations when we remeasured an unrecognized tax benefit liability related to the 2007 sale of Peoples Energy Production Company, including an adjustment for a lapse in the statute of limitations for certain states associated with these tax filings.

WPS Niagara Generation, LLC

During 2009, Integrys Energy Services recorded a $0.4 million after-tax gain in discontinued operations related to a refund received in connection with the overpayment for auxiliary power service in prior years.

NOTE 6—PROPERTY, PLANT, AND EQUIPMENT

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

(Millions)	2011	2010
Electric utility	$3,139.7	$3,095.5
Natural gas utility	4,751.4	4,506.3
Total utility plant	7,891.1	7,601.8
Less: Accumulated depreciation	2,910.1	2,794.2
Net	4,981.0	4,807.6
Construction work in progress	62.0	39.5
Net utility plant	5,043.0	4,847.1
Nonutility plant	130.4	143.9
Less: Accumulated depreciation	68.7	70.2
Net	61.7	73.7
Construction work in progress	2.7	1.6
Net nonutility plant	64.4	75.3
Integrys Energy Services energy assets	100.6	98.9
Integrys Energy Services other	20.0	21.1
Other nonregulated	8.0	6.0
Total nonregulated property, plant, and equipment	128.6	126.0
Less: Accumulated depreciation	39.9	35.8
Net	88.7	90.2
Construction work in progress	3.0	0.8
Net nonregulated property, plant, and equipment	91.7	91.0
Total property, plant, and equipment	$5,199.1	$5,013.4

We evaluate property, plant, and equipment for impairment whenever indicators of impairment exist. During the fourth quarter of 2011, Integrys Energy Services recorded a pre-tax non-cash impairment loss of $4.6 million related to its Winnebago Energy Center, a landfill-gas-to-electric facility. During the third quarter of 2010, Integrys Energy Services recorded a pre-tax non-cash impairment loss of $43.2 million related to its three natural gas-fired generation plants (Beaver Falls Generation, Syracuse Generation, and Combined Locks Energy Center). The impairment charges resulted from lower estimated future cash flows for these facilities and were primarily driven by forward energy and capacity prices. The impairment charges were reported as impairment losses on property, plant, and equipment in the income statements. The fair values of the facilities were determined primarily using the income approach, which was based on discounted cash flows that were derived from internal forecasts using externally supplied forward energy and capacity pricing curves. Renewable energy credits were also considered for the Winnebago Energy Center. Other assumptions included forecasted operating expenses, forecasted capital additions, anticipated working capital requirements, and the discount rate. The discount rate represents the estimated cost of capital appropriate for each facility and is also based upon the cash flow period used for the fair value assessment. The discount rate used for the Winnebago Energy Center impairment analysis in 2011 was 7.5%. The discount rate used for the natural gas-fired plants impairment analysis in 2010 was 10%.

NOTE 7—JOINTLY OWNED UTILITY FACILITIES

WPS holds a joint ownership interest in certain electric generating facilities. WPS is entitled to its share of generating capability and output of each facility equal to its respective ownership interest. WPS also pays its ownership share of additional construction costs, fuel inventory purchases, and operating expenses, unless specific agreements have been executed to limit its maximum exposure to additional costs. WPS recorded its proportionate share of significant jointly owned electric generating facilities on the balance sheets, and the amounts were as follows at December 31, 2011:

(Millions, except for percentages and megawatts)	Weston 4	Columbia Energy Center Units 1 and 2	Edgewater Unit No. 4
Ownership	70.0%	31.8%	31.8%
WPS's share of rated capacity (megawatts)	374.5	335.2	105.0
Utility plant in service	$573.3	$167.8	$39.8
Accumulated depreciation	$78.5	$106.6	$25.4
In-service date	2008	1975 and 1978	1969

WPS's proportionate share of direct expenses for the joint operation of these plants is recorded in operating expenses in the income statements. WPS has supplied its own financing for all jointly owned projects.

NOTE 8—REGULATORY ASSETS AND LIABILITIES

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

Most of our regulatory assets are earning a return, except for costs associated with WPS environmental remediation, unamortized loss on reacquired debt at WPS, PGL, NSG, and UPPCO, the Weston 3 lightning strike, and MERC's conservation program. The carrying costs related to the regulatory assets not earning a return are borne by our shareholders. The following regulatory assets and liabilities were reflected in our balance sheets as of December 31:

(Millions)	2011	2010	See Note
Regulatory assets			
Unrecognized pension and other postretirement benefit costs	**$ 733.6**	$ 544.5	18
Environmental remediation costs (net of insurance recoveries) [1]	**626.8**	653.0	16
Merger and acquisition related pension and other postretirement benefit costs [2]	**121.9**	133.8	
Derivatives	**59.0**	34.1	1(h)
Asset retirement obligations	**58.1**	47.6	14
Income tax related items	**37.9**	28.1	15
Decoupling	**33.3**	50.5	26
De Pere Energy Center [3]	**28.6**	31.0	
Unamortized loss on reacquired debt [4]	**18.8**	14.6	1(n)
Conservation program costs [5]	**13.3**	15.3	
Weston 3 lightning strike [6]	**10.9**	14.5	
Other	**41.4**	46.0	
Total	**$ 1,783.6**	$1,613.0	
Balance Sheet Presentation			
Current	**$ 125.1**	$ 117.9	
Long-term	**1,658.5**	1,495.1	
Total	**$ 1,783.6**	$1,613.0	
Regulatory liabilities			
Removal costs [7]	**$ 298.0**	$ 278.1	
Energy costs refundable through rate adjustments [8]	**30.4**	51.8	
Unrecognized pension and other postretirement benefit costs	**18.4**	20.0	18
Decoupling	**17.2**	8.1	26
Uncollectible expense	**11.3**	8.3	26
Derivatives	**9.3**	6.0	1(h)
Energy Efficiency Program [5]	**5.4**	7.2	
Other	**10.0**	12.4	
Total	**$ 400.0**	$ 391.9	
Balance Sheet Presentation			
Current	**$ 67.5**	$ 75.7	
Long-term	**332.5**	316.2	
Total	**$ 400.0**	$ 391.9	

[1] As of December 31, 2011, we had not yet made cash expenditures for $615.1 million of these environmental remediation costs. The recovery of environmental remediation costs depends on the timing of the actual expenditures.

[2] Composed of unrecognized benefit costs that existed prior to the PELLC merger and the MERC and MGU acquisitions.

[3] Prior to WPS purchasing the De Pere Energy Center, WPS had a long-term power purchase contract with the De Pere Energy Center that was accounted for as a capital lease. As a result of the purchase, the capital lease obligation was reversed and the difference between the capital lease asset and the purchase price was recorded as a regulatory asset. WPS is authorized recovery of this regulatory asset through 2023.

[4] Amounts for PGL and NSG are recovered over the term of the replacement debt as authorized by the ICC. WPS is authorized recovery of this regulatory asset through 2015. UPPCO is authorized recovery of this regulatory asset through 2018.

[5] Represents amounts recoverable from and/or refundable to customers related to programs designed to meet energy efficiency standards. MERC is authorized recovery of this regulatory asset through 2012.

[6] In 2007, a lightning strike caused significant damage to the Weston 3 generating facility. The PSCW approved the deferral of the incremental fuel and purchased power expenses, as well as the non-fuel operating and maintenance expenditures incurred as a result of the outage that were not covered by insurance. WPS is authorized recovery of this regulatory asset through 2014.

[7] Represents amounts collected from customers to cover the cost of future removal of property, plant, and equipment.

[8] Represents the over-collection of energy costs from customers that will be refunded in the future.

NOTE 9—INVESTMENTS IN AFFILIATES, AT EQUITY METHOD

Investments in corporate joint ventures and other companies accounted for under the equity method at December 31, 2011, and 2010 were as follows:

(Millions)	2011	2010
ATC	**$439.4**	$416.3
INDU Solar Holdings, LLC	**28.4**	0.1
WRPC	**7.7**	8.1
Other	**0.8**	1.0
Investments in affiliates, at equity method	**$476.3**	$425.5

Investments in affiliates accounted for under the equity method are included in other long-term assets on the Balance Sheets, and the equity income is recorded in miscellaneous income on the Statements of Income. We are taxed on ATC's equity income, due to the tax flow-through nature of ATC's business structure. Accordingly, our provision for income taxes includes taxes on ATC's equity income.

ATC

Our electric transmission investment segment consists of WPS Investments LLC's ownership interest in ATC, which was approximately 34% at December 31, 2011. ATC is a for-profit, transmission-only company regulated by FERC. ATC owns, maintains, monitors, and operates electric transmission assets in portions of Wisconsin, Michigan, Minnesota, and Illinois.

The following table shows changes to our investment in ATC during the years ended December 31:

(Millions)	2011	2010	2009
Balance at the beginning of period	**$416.3**	$395.9	$346.9
Add: Equity in net income	**79.1**	77.6	75.3
Add: Capital contributions	**8.5**	6.8	34.1
Less: Dividends received	**64.5**	64.0	60.4
Balance at the end of period	**$439.4**	$416.3	$395.9

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

(Millions)	2011	2010	2009
Total charges to ATC for services and construction	**$ 13.5**	$ 14.0	$10.1
Total costs for network transmission service provided by ATC	**102.7**	103.0	90.7

INDU Solar Holdings, LLC

Integrys Solar, LLC, a subsidiary of Integrys Energy Services, owns 50% of INDU Solar Holdings, LLC. INDU Solar Holdings, LLC owns solar energy projects in California, Pennsylvania, New Jersey, and Arizona that deliver electricity and related products to commercial, government and utility customers under long-term power purchase agreements.

The following table shows changes to our investment in INDU Solar Holdings, LLC during the years ended December 31:

(Millions)	2011	2010
Balance at the beginning of period	**$ 0.1**	$ -
Add: Equity in net loss	**(0.7)**	(0.4)
Add: Capital contributions	**29.0**	0.5
Balance at the end of period	**$28.4**	$0.1

WRPC

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

The following table shows changes to our investment in WRPC during the years ended December 31:

(Millions)	2011	2010	2009
Balance at the beginning of period	**$8.1**	$8.5	$8.4
Add: Equity in net income	**0.9**	1.0	1.0
Less: Dividends received	**1.3**	1.4	0.9
Balance at the end of period	**$7.7**	$8.1	$8.5

WPS provides services to WRPC, purchases energy from WRPC, and receives net proceeds from sales of energy into the MISO market from WRPC. The related party transactions recorded by WPS during the years ended December 31 were as follows:

(Millions)	2011	2010	2009
Revenues from services provided to WRPC	**$0.7**	$0.6	$0.6
Purchases of energy from WRPC	**4.9**	4.7	4.6
Net proceeds from WRPC sales of energy to MISO	**4.7**	4.5	2.6

Financial Data

Combined financial data of our significant equity method investments, ATC, INDU Solar Holdings, LLC, and WRPC, is included in the table below:

(Millions)	2011	2010	2009 *
Income statement data			
Revenues	**$ 575.5**	$ 564.1	$ 528.7
Operating expenses	**269.6**	257.6	235.7
Other expense	**81.5**	85.7	77.7
Net income	**$ 224.4**	$ 220.8	$ 215.3
Equity in net income	**$ 79.4**	$ 78.2	$ 76.3
Balance sheet data			
Current assets	**$ 91.1**	$ 62.7	$ 54.0
Noncurrent assets	**3,120.5**	2,906.2	2,785.5
Total assets	**$3,211.6**	$2,968.9	$2,839.5
Current liabilities	**$ 319.9**	$ 429.0	$ 286.3
Long-term debt	**1,400.0**	1,175.0	1,259.6
Other noncurrent liabilities	**88.0**	88.5	80.1
Shareholders' equity	**1,403.7**	1,276.4	1,213.5
Total liabilities and shareholders' equity	**$3,211.6**	$2,968.9	$2,839.5

* Combined financial data for 2009 does not include INDU Solar Holdings, LLC as it was formed in 2010.

NOTE 10—GOODWILL AND OTHER INTANGIBLE ASSETS

We had the following changes in the gross amount of goodwill and the accumulated impairment losses for the years ended December 31, 2011 and 2010:

	Natural Gas Segment		Integrys Energy Services		Holding Company and Other		Total	
(Millions)	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Balance as of January 1								
Gross goodwill	**$933.5**	$933.5	**$6.6**	$6.6	**$ -**	$ -	**$940.1**	$940.1
Accumulated impairment losses	**(297.6)**	(297.6)	**-**	-	**-**	-	**(297.6)**	(297.6)
Net goodwill	**635.9**	635.9	**6.6**	6.6	**-**	-	**642.5**	642.5
Goodwill acquired	**-**	-	**-**	-	**15.9**	-	**15.9**	-
Balance as of December 31								
Gross goodwill	**933.5**	933.5	**6.6**	6.6	**15.9**	-	**956.0**	940.1
Accumulated impairment losses	**(297.6)**	(297.6)	**-**	-	**-**	-	**(297.6)**	(297.6)
Net goodwill	**$635.9**	$635.9	**$6.6**	$6.6	**$15.9**	$ -	**$658.4**	$642.5

In the second quarter of 2011, annual impairment tests were completed at all of our reporting units that carried a goodwill balance. No impairments resulted from these tests.

In the first quarter of 2009, the combination of the decline in equity markets as well as the increase in the expected weighted-average cost of capital triggered an interim goodwill impairment analysis. Based upon the results of this analysis, Integrys Energy Group recorded a noncash goodwill impairment loss of $291.1 million ($248.8 million after tax) in the first quarter of 2009, all within the natural gas utility segment. A combination of the income approach and the market approach were used to estimate the fair values of PGL, NSG, MERC, and MGU. The income approach was used to estimate the fair value of Integrys Energy Services. Key factors contributing to the impairment charge included disruptions in the global credit and equity markets and the resulting increase in the weighted-average cost of capital used to value the natural gas utility operations, and the negative impact that the global decline in equity markets had on the valuation of natural gas distribution companies in general.

In connection with the acquisition of Trillium and Pinnacle, we recorded goodwill of $15.9 million and intangible assets of $20.2 million in the third quarter of 2011. The allocated fair market values and the approximate amortization periods by major intangible asset class were as follows:

	Fair Market Value	Approximate Amortization Period (in years)
Patents	$ 7.2	18
Compressed natural gas fueling contract assets	5.6	10
Customer relationships	1.9	15
Trade names	5.0	Indefinite life
Software	0.5	3
Total	$20.2	

The identifiable intangible assets other than goodwill listed below are part of other current and long-term assets on the Balance Sheets.

(Millions)	December 31, 2011			December 31, 2010		
	Gross Carrying Amount	**Accumulated Amortization**	**Net**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net**
Amortized intangible assets						
Customer-related [1]	**$34.5**	**$(24.8)**	**$ 9.7**	$32.6	$(21.8)	$10.8
Natural gas and electric contract assets [2] [3]	**7.8**	**(6.6)**	**1.2**	57.1	(55.0)	2.1
Patents [4]	**7.2**	**-**	**7.2**	-	-	-
Compressed natural gas fueling contract assets [5]	**5.6**	**(0.3)**	**5.3**	-	-	-
Natural gas and electric contract liabilities [2]	**-**	**-**	**-**	(10.5)	10.5	-
Renewable energy credits [6]	**2.8**	**-**	**2.8**	2.5	-	2.5
Nonregulated easements [7]	**3.8**	**(0.7)**	**3.1**	3.8	(0.4)	3.4
Customer-owned equipment modifications [8]	**3.6**	**(0.2)**	**3.4**	1.6	(0.1)	1.5
Emission allowances [9]	**1.7**	**(0.2)**	**1.5**	1.9	(0.2)	1.7
Other	**1.4**	**(0.3)**	**1.1**	0.8	(0.3)	0.5
Total	**$68.4**	**$(33.1)**	**$35.3**	$89.8	$(67.3)	$22.5
Unamortized intangible assets						
MGU trade name	**$ 5.2**	**-**	**$ 5.2**	$ 5.2	-	$ 5.2
Trillium trade name	**3.5**	**-**	**3.5**	-	-	-
Pinnacle trade name	**1.5**	**-**	**1.5**	-	-	-
Total intangible assets	**$78.6**	**$(33.1)**	**$45.5**	$95.0	$(67.3)	$27.7

[1] Includes customer relationship assets associated with PELLC's former nonregulated retail natural gas and electric operations, MERC's nonutility ServiceChoice business, and Trillium and Pinnacle compressed natural gas fueling operations. The remaining weighted-average amortization period for customer-related intangible assets at December 31, 2011, was approximately 10 years.

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

[3] Includes both short-term and long-term intangible assets related to customer contracts in the amount of $0.5 million and $0.7 million, respectively, at December 31, 2011, and $0.9 million and $1.2 million, respectively, at December 31, 2010. The remaining amortization period at December 31, 2011, was approximately three years.

[4] Includes the fair value of patents at Pinnacle related to a system for more efficiently compressing natural gas to allow for faster fueling. The remaining amortization period at December 31, 2011, was approximately 18 years.

[5] Represents the fair value of Trillium and Pinnacle compressed natural gas customer fueling contracts acquired in September 2011. The remaining amortization period at December 31, 2011, was approximately 9 years.

[6] Used at Integrys Energy Services to comply with state Renewable Portfolio Standards and to support customer commitments.

[7] Relates to easements supporting a pipeline at Integrys Energy Services. The easements are amortized on a straight-line basis, with a remaining amortization period at December 31, 2011, of approximately 12 years.

[8] Relates to modifications to customer-owned equipment that allows the end-use customer of a pipeline to accept landfill gas. These intangible assets are amortized on a straight-line basis, with a remaining weighted average amortization period at December 31, 2011, of approximately 12 years.

[9] Emission allowances do not have a contractual term or expiration date. If the EPA's Cross State Air Pollution Rule, which was stayed in December 2011, is reinstated, it will affect our ability to use certain existing emission allowances in the future. See Note 16, "*Commitments and Contingencies*," for more information.

Amortization recorded as a component of nonregulated cost of sales in the Statements of Income for the years ended December 31, 2011, 2010, and 2009, was $1.4 million, $4.9 million, and $8.9 million, respectively.

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

(Millions)	
For year ending December 31, 2012	$4.8
For year ending December 31, 2013	2.2
For year ending December 31, 2014	1.7
For year ending December 31, 2015	1.3
For year ending December 31, 2016	1.0

Amortization expense recorded as a component of depreciation and amortization expense in the Statements of Income for the years ended December 31, 2011, 2010, and 2009, was $3.4 million, $3.9 million, and $6.3 million, respectively.

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

(Millions)	
For year ending December 31, 2012	$2.7
For year ending December 31, 2013	2.1
For year ending December 31, 2014	1.8
For year ending December 31, 2015	1.6
For year ending December 31, 2016	1.5

NOTE 11—LEASES

We lease various property, plant, and equipment. Terms of the operating leases vary, but generally require us to pay property taxes, insurance premiums, and maintenance costs associated with the leased property. Many of our leases contain one of the following options upon the end of the lease term: (a) purchase the property at the current fair market value or (b) exercise a renewal option, as set forth in the lease agreement. Rental expense attributable to operating leases was $12.6 million, $15.2 million, and $16.9 million in 2011, 2010, and 2009, respectively. Future minimum rental obligations under non-cancelable operating leases are payable as follows:

Year ending December 31 *(Millions)*	
2012	$ 8.5
2013	8.8
2014	5.0
2015	4.1
2016	4.0
Later years	51.2
Total payments	$81.6

NOTE 12—SHORT-TERM DEBT AND LINES OF CREDIT

Our outstanding short-term borrowings were as follows as of December 31:

(Millions, except percentages)	2011	2010	2009
Commercial paper outstanding	**$303.3**	-	$212.1
Average discount rate on outstanding commercial paper	**0.31%**	-	0.52%
Short-term notes payable outstanding	-	$10.0	$10.0
Average interest rate on short-term notes payable outstanding	-	0.32%	0.18%

The commercial paper outstanding at December 31, 2011, had maturity dates ranging from January 3, 2012 through January 26, 2012.

The table below presents our average amount of short-term borrowings outstanding based on daily outstanding balances during the years ended December 31:

(Millions)	2011	2010	2009
Average amount of commercial paper outstanding	**$134.9**	$66.9	$193.8
Average amount of borrowings outstanding under revolving credit facilities	-	-	114.5
Average amount of short-term notes payable outstanding	**3.6**	10.0	48.0

We manage our liquidity by maintaining adequate external financing commitments. The information in the table below relates to our short-term debt, lines of credit, and remaining available capacity as of December 31:

(Millions)	Maturity	2011	2010
Revolving credit facility (Integrys Energy Group) [1]	04/23/13	**$ 735.0**	$ 735.0
Revolving credit facility (Integrys Energy Group) [2]	06/09/11	**-**	500.0
Revolving credit facility (Integrys Energy Group) [3]	05/17/16	**200.0**	-
Revolving credit facility (Integrys Energy Group) [3]	05/17/14	**275.0**	-
Revolving credit facility (WPS) [1]	04/23/13	**115.0**	115.0
Revolving credit facility (WPS) [4]	05/15/12	**135.0**	-
Revolving credit facility (PELLC) [2]	06/13/11	**-**	400.0
Revolving credit facility (PGL) [1]	04/23/13	**250.0**	250.0
Revolving short-term notes payable (WPS) [2]	05/13/11	**-**	10.0
Total short-term credit capacity		**$1,710.0**	$2,010.0
Less:			
Letters of credit issued inside credit facilities		**33.7**	64.9
Loans outstanding under credit agreements and notes payable		**-**	10.0
Commercial paper outstanding		**303.3**	-
Available capacity under existing agreements		**$1,373.0**	$1,935.1

(1) Supports commercial paper borrowing program.

(2) These credit facilities and short-term note payable were terminated/repaid in the second quarter of 2011.

(3) In May 2011, we entered into two new revolving credit agreements to support our commercial paper borrowing program.

(4) In May 2011, WPS entered into a new revolving credit agreement to support its commercial paper borrowing program. WPS requested approval from the PSCW to extend this facility through May 17, 2014.

At December 31, 2011, we and each of our subsidiaries were in compliance with all respective financial covenants related to outstanding short-term debt. Our revolving credit agreements and those of certain of our subsidiaries contain financial and other covenants, including but not limited to, a requirement to maintain a debt to total capitalization ratio not to exceed 65%, excluding non-recourse debt. Failure to comply with these covenants could result in an event of default, which could result in the acceleration of outstanding debt obligations.

NOTE 13—LONG-TERM DEBT

(Millions)				December 31 2011	2010
WPS First Mortgage Bonds [1]					
	Series	Year Due			
	7.125%	2023		$ 0.1	$ 0.1
WPS Senior Notes [1] [2] [3]					
	Series	Year Due			
	6.125%	2011		-	150.0
	4.875%	2012		**150.0**	150.0
	4.80%	2013		**125.0**	125.0
	3.95%	2013		**22.0**	22.0
	6.375%	2015		**125.0**	125.0
	5.65%	2017		**125.0**	125.0
	6.08%	2028		**50.0**	50.0
	5.55%	2036		**125.0**	125.0
UPPCO First Mortgage Bonds [4]					
	Series	Year Due			
	9.32%	2021		-	9.4
PELLC Unsecured Senior Note [5]					
	Series	Year Due			
	6.90%	2011		-	325.0
Fair value hedge adjustment				-	0.9
PGL Fixed First and Refunding Mortgage Bonds [6]					
	Series	Year Due			
	KK, 5.00%	2033		**50.0**	50.0
	NN-2, 4.625%	2013		**75.0**	75.0
	QQ, 4.875%	2038	Adjustable after November 1, 2018	**75.0**	75.0
	RR, 4.30%	2035	Adjustable after June 1, 2016	**50.0**	50.0
	SS, 7.00%	2013		**45.0**	45.0
	TT, 8.00%	2018		**5.0**	5.0
	UU, 4.63%	2019		**75.0**	75.0
	VV, 2.125%	2030	Mandatory interest reset date on July 1, 2014	**50.0**	50.0
	WW, 2.625%	2033	Mandatory interest reset date on August 1, 2015	**50.0**	50.0
	XX, 2.21%	2016		**50.0**	-
PGL Adjustable First and Refunding Mortgage Bonds [7]					
	Series	Year Due			
	OO	2037		-	51.0
NSG First Mortgage Bonds [8]					
	Series	Year Due			
	M, 5.00%	2028		**28.2**	28.3
	N-2, 4.625%	2013		**40.0**	40.0
	O, 7.00%	2013		**6.5**	6.5
Integrys Energy Group Unsecured Senior Notes [9]					
	Series	Year Due			
	5.375%	2012		**100.0**	100.0
	7.27%	2014		**100.0**	100.0
	8.00%	2016		**55.0**	55.0
	4.17%	2020		**250.0**	250.0
Integrys Energy Group Unsecured Junior Subordinated Notes [10]					
	Series	Year Due			
	6.11%	2066		**269.8**	300.0
Other term loan [11]				**27.0**	27.0
Total				**2,123.6**	2,640.2
Unamortized discount and premium on bonds and debt				**(1.6)**	(1.7)
Total debt				**2,122.0**	2,638.5
Less current portion				**(250.0)**	(476.9)
Total long-term debt				**$1,872.0**	$2,161.6

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

(2) In August 2011, WPS's $150.0 million of 6.125% Senior Notes matured, and the outstanding principal balance was repaid.

(3) In December 2012, WPS's 4.875% Senior Notes will mature. As a result, the $150.0 million balance of these notes was included in current portion of long-term debt on Integrys Energy Group's Consolidated Balance Sheets at December 31, 2011.

(4) In November 2011, UPPCO bought back its $9.4 million of 9.32% First Mortgage Bonds that were due in November 2021.

(5) In January 2011, PELLC's 6.9% unsecured Senior Notes matured, and the outstanding principal balance was repaid. In January 2011, Integrys Energy Group settled the interest rate swap designated as a fair value hedge associated with $50.0 million of the senior notes. See Note 2, "*Risk Management Activities*," for more information.

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

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

In November 2011, PGL issued $50.0 million of 2.21% Series XX First Mortgage Bonds. These bonds are due in November 2016.

(7) In August 2011, PGL bought back its $51.0 million of Adjustable Rate, Series OO bonds that were due October 1, 2037.

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

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

(9) In December 2012, the 5.375% Unsecured Senior Notes will mature. As a result, the $100.0 million balance of these notes was included in current portion of long-term debt on Integrys Energy Group's Consolidated Balance Sheets at December 31, 2011.

(10) These Junior Subordinated Notes are considered hybrid instruments with a combination of debt and equity characteristics. In May 2011, we bought back $30.2 million of these Junior Subordinated Notes. Under a replacement capital covenant with the holders of our 4.17% Unsecured Senior Notes due November 1, 2020, any amounts bought back in excess of 10% of the principal amount outstanding must first be replaced with a specified amount of proceeds from the sale of qualifying securities that have equity-like characteristics that are the same as, or more equity-like than, the applicable characteristics of the Junior Subordinated Notes.

(11) In April 2001, the Schuylkill County Industrial Development Authority issued $27.0 million of Refunding Tax Exempt Bonds. The proceeds from the bonds were loaned to WPS Westwood Generation, LLC, a subsidiary of Integrys Energy Services. WPS Westwood Generation pays interest monthly to Schuylkill County Industrial Development Authority. The loan has a floating interest rate that is reset weekly. At December 31, 2011, the interest rate was 0.09%. The loan is to be repaid by April 2021. In January 2011, we replaced our guarantee to provide sufficient funds to pay the loan and the related obligations and indemnities on WPS Westwood Generation's obligation with a standby letter of credit. See Note 17, "*Guarantees*," for additional information.

At December 31, 2011, we and each of our subsidiaries were in compliance with all respective financial covenants related to outstanding long-term debt. Our long-term debt obligations, and those of certain of our subsidiaries, contain covenants related to payment of principal and interest when due and various financial reporting obligations. In addition, certain long-term debt obligations contain financial and other covenants, including but not limited to, a requirement to maintain a debt to total capitalization ratio not to exceed 65%. Failure to comply with these covenants could result in an event of default, which could result in the acceleration of outstanding debt obligations.

A schedule of all principal debt payment amounts related to bond maturities is as follows:

Year ending December 31 *(Millions)*	
2012	$ 250.0
2013	313.5
2014	100.0
2015	125.0
2016	105.0
Later years	1,230.1
Total payments	$2,123.6

NOTE 14—ASSET RETIREMENT OBLIGATIONS

The utility segments have asset retirement obligations primarily related to removal of natural gas distribution mains and service pipes (including asbestos and PCBs); asbestos abatement at certain generation facilities, office buildings, and service centers; dismantling wind generation projects; disposal of PCB-contaminated transformers; closure of fly-ash landfills at certain generation facilities; and removal of above ground storage tanks. The utilities establish regulatory assets and liabilities to record the differences between ongoing expense recognition under the asset retirement obligations accounting rules, and the ratemaking practices for retirement costs authorized by the applicable regulators. Integrys Energy Services has asset retirement obligations related to the removal of solar equipment components.

The following table shows changes to our asset retirement obligations through December 31, 2011:

(Millions)	Utilities	Integrys Energy Services	Total
Asset retirement obligations at December 31, 2008	$178.9	$0.2 (2)	$179.1
Accretion	9.6	0.1	9.7
Additions and revisions to estimated cash flows	6.3 (1)	-	6.3
Asset retirement obligations at December 31, 2009	194.8	0.3 (2)	195.1
Accretion	11.7	-	11.7
Asset retirement obligations transferred in sale	-	(0.3)	(0.3)
Additions and revisions to estimated cash flows	120.5 (3)	-	120.5
Settlements	(6.1)	-	(6.1)
Asset retirement obligations at December 31, 2010	320.9	-	320.9
Accretion	**17.1**	-	**17.1**
Additions and revisions to estimated cash flows	**64.4** (4)	**0.5**	**64.9**
Settlements	**(5.7)**	-	**(5.7)**
Asset retirement obligations at December 31, 2011	**$396.7**	**$0.5**	**$397.2**

(1) This amount includes a $6.3 million asset retirement obligation related to the WPS 99-megawatt Crane Creek wind generation project that became operational in the fourth quarter of 2009. All other adjustments netted to an insignificant amount.

(2) These amounts were classified as held for sale, as they related to the sale of generation assets in Northern Maine, which closed in the first quarter of 2010.

(3) Revisions were made to estimated cash flows related to asset retirement obligations for natural gas distribution pipes at PGL due to changes in the average remaining service life of distribution pipe based upon an updated depreciation study, as well as an increase in estimated costs.

(4) Revisions were made to estimated cash flows related to asset retirement obligations primarily due to an increase in the weighted average cost to retire a foot of natural gas distribution pipe at PGL.