

INTEGRYS ENERGY GROUP, INC.

Form 10-Q

November 06, 2012

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from to

Commission
File Number

1-11337

Registrant; State of Incorporation;
Address; and Telephone Number

INTEGRYS ENERGY GROUP, INC.

(A Wisconsin Corporation)
130 East Randolph Street
Chicago, Illinois 60601-6207
(312) 228-5400

Internal Revenue Service
Employer
Identification No.

39-1775292

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Common stock, \$1 par value,
78,287,906 shares outstanding at
October 30, 2012

Table of Contents

INTEGRYS ENERGY GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q

For the Quarter Ended September 30, 2012

TABLE OF CONTENTS

	Page
<u>FORWARD-LOOKING STATEMENTS</u>	1
<u>PART I. FINANCIAL INFORMATION</u>	2
<u>ITEM 1. FINANCIAL STATEMENTS (Unaudited)</u>	2
<u>Condensed Consolidated Statements of Income</u>	2
<u>Condensed Consolidated Statements of Comprehensive Income</u>	3
<u>Condensed Consolidated Balance Sheets</u>	4
<u>Condensed Consolidated Statements of Cash Flows</u>	5
<u>CONDENSED NOTES TO FINANCIAL STATEMENTS OF</u> <u>Integrys Energy Group, Inc. and Subsidiaries</u>	6 38
	Page
<u>Note 1</u> <u>Financial Information</u>	6
<u>Note 2</u> <u>Cash and Cash Equivalents</u>	6
<u>Note 3</u> <u>Risk Management Activities</u>	7
<u>Note 4</u> <u>Agreement to Purchase Fox Energy Center</u>	11
<u>Note 5</u> <u>Discontinued Operations</u>	11
<u>Note 6</u> <u>Investment in ATC</u>	13
<u>Note 7</u> <u>Inventories</u>	14
<u>Note 8</u> <u>Goodwill and Other Intangible Assets</u>	14
<u>Note 9</u> <u>Short-Term Debt and Lines of Credit</u>	16
<u>Note 10</u> <u>Long-Term Debt</u>	17
<u>Note 11</u> <u>Income Taxes</u>	17
<u>Note 12</u> <u>Commitments and Contingencies</u>	18
<u>Note 13</u> <u>Guarantees</u>	22
<u>Note 14</u> <u>Employee Benefit Plans</u>	23
<u>Note 15</u> <u>Stock-Based Compensation</u>	23
<u>Note 16</u> <u>Common Equity</u>	26
<u>Note 17</u> <u>Variable Interest Entities</u>	28
<u>Note 18</u> <u>Fair Value</u>	29
<u>Note 19</u> <u>Advertising Costs</u>	33
<u>Note 20</u> <u>Regulatory Environment</u>	33
<u>Note 21</u> <u>Segments of Business</u>	36
<u>Note 22</u> <u>New Accounting Pronouncements</u>	38
<u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	39 58

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

<u>ITEM 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	59
<u>ITEM 4.</u>	<u>Controls and Procedures</u>	60
<u>PART II.</u>	<u>OTHER INFORMATION</u>	61
<u>ITEM 1.</u>	<u>Legal Proceedings</u>	61
<u>ITEM 1A.</u>	<u>Risk Factors</u>	61
<u>ITEM 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	61
<u>ITEM 5.</u>	<u>Other Information</u>	62
<u>ITEM 6.</u>	<u>Exhibits</u>	62
<u>Signature</u>		63
<u>EXHIBIT INDEX</u>		64

Table of Contents

Commonly Used Acronyms in this Quarterly Report on Form 10-Q

AFUDC	Allowance for Funds Used During Construction
AMRP	Accelerated Natural Gas Main Replacement Program
ASU	Accounting Standards Update
ATC	American Transmission Company LLC
EPA	United States Environmental Protection Agency
FERC	Federal Energy Regulatory Commission
GAAP	United States Generally Accepted Accounting Principles
IBS	IntegrYS Business Support, LLC
ICC	Illinois Commerce Commission
ICR	Infrastructure Cost Recovery
ITF	IntegrYS Transportation Fuels, LLC (doing business as Trillium CNG)
LIFO	Last-in, First-out
MERC	Minnesota Energy Resources Corporation
MGU	Michigan Gas Utilities Corporation
MISO	Midwest Independent Transmission System Operator, Inc.
MPSC	Michigan Public Service Commission
MPUC	Minnesota Public Utilities Commission
N/A	Not Applicable
NSG	North Shore Gas Company
OCI	Other Comprehensive Income
PELLC	Peoples Energy, LLC (formerly known as Peoples Energy Corporation)
PGL	The Peoples Gas Light and Coke Company
PSCW	Public Service Commission of Wisconsin
SEC	United States Securities and Exchange Commission
UPPCO	Upper Peninsula Power Company
WDNR	Wisconsin Department of Natural Resources
WPS	Wisconsin Public Service Corporation

Table of Contents

Forward-Looking Statements

In this report, we make statements concerning our expectations, beliefs, plans, objectives, goals, strategies, and future events or performance. These statements are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are not guarantees of future results and conditions, but rather are subject to numerous management assumptions, risks, and uncertainties. Therefore, actual results may differ materially from those expressed or implied by these statements. Although we believe that these forward-looking statements and the underlying assumptions are reasonable, we cannot provide assurance that such statements will prove correct.

Forward-looking statements involve a number of risks and uncertainties. Some risks that could cause actual results to differ materially from those expressed or implied in forward-looking statements include those described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011, as may be amended or supplemented in Part II, Item 1A of our subsequently filed Quarterly Reports on Form 10-Q (including this report), and those identified below:

- The timing and resolution of rate cases and related negotiations, including recovery of deferred and current costs and the ability to earn a reasonable return on investment, and other regulatory decisions impacting our regulated businesses;
- Federal and state legislative and regulatory changes relating to the environment, including climate change and other environmental regulations impacting coal-fired generation facilities and renewable energy standards;
- Other federal and state legislative and regulatory changes, including deregulation and restructuring of the electric and natural gas utility industries, financial reform, health care reform, energy efficiency mandates, reliability standards, pipeline integrity and safety standards, and changes in tax and other laws and regulations to which we and our subsidiaries are subject;
- Costs and effects of litigation and administrative proceedings, settlements, investigations, and claims, including manufactured gas plant site cleanup, third-party intervention in permitting and licensing projects, compliance with Clean Air Act requirements at generation plants, and prudence and reconciliation of costs recovered in revenues through automatic gas cost recovery mechanisms;
- Changes in credit ratings and interest rates caused by volatility in the financial markets and actions of rating agencies and their impact on our and our subsidiaries' liquidity and financing efforts;
- The risks associated with changing commodity prices, particularly natural gas and electricity, and the available sources of fuel, natural gas, and purchased power, including their impact on margins, working capital, and liquidity requirements;
- The timing and outcome of any audits, disputes, and other proceedings related to taxes;
- The effects, extent, and timing of additional competition or regulation in the markets in which our subsidiaries operate;
- The ability to retain market-based rate authority;
- The risk associated with the value of goodwill or other intangible assets and their possible impairment;

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

- The investment performance of employee benefit plan assets and related actuarial assumptions, which impact future funding requirements;
- The impact of unplanned facility outages;
- Changes in technology, particularly with respect to new, developing, or alternative sources of generation;
- The effects of political developments, as well as changes in economic conditions and the related impact on customer use, customer growth, and our ability to adequately forecast energy use for all of our customers;
- Potential business strategies, including mergers, acquisitions, and construction or disposition of assets or businesses, which cannot be assured to be completed timely or within budgets;
- The risk of terrorism or cyber security attacks, including the associated costs to protect our assets and respond to such events;
- The risk of failure to maintain the security of personally identifiable information, including the associated costs to notify affected persons and to mitigate their information security concerns;
- The effectiveness of risk management strategies, the use of financial and derivative instruments, and the related recovery of these costs from customers in rates;
- The risk of financial loss, including increases in bad debt expense, associated with the inability of our and our subsidiaries counterparties, affiliates, and customers to meet their obligations;
- Unusual weather and other natural phenomena, including related economic, operational, and/or other ancillary effects of any such events;
- The ability to use tax credit and loss carryforwards;
- The financial performance of ATC and its corresponding contribution to our earnings;
- The effect of accounting pronouncements issued periodically by standard-setting bodies; and
- Other factors discussed elsewhere herein and in other reports we file with the SEC.

Except to the extent required by the federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****INTEGRYS ENERGY GROUP, INC.**

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited) (Millions, except per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Utility revenues	\$ 582.3	\$ 596.2	\$ 2,116.9	\$ 2,435.7
Nonregulated revenues	345.3	338.2	898.6	1,130.1
Total revenues	927.6	934.4	3,015.5	3,565.8
Utility cost of fuel, natural gas, and purchased power	228.2	245.7	926.4	1,211.6
Nonregulated cost of sales	263.9	292.8	730.4	985.1
Operating and maintenance expense	240.6	240.3	749.1	760.4
Depreciation and amortization expense	62.9	61.8	187.7	185.3
Taxes other than income taxes	23.8	23.5	74.0	73.5
Operating income	108.2	70.3	347.9	349.9
Earnings from equity method investments	22.2	19.9	65.5	59.6
Miscellaneous income	3.1	1.0	7.2	4.1
Interest expense	(29.9)	(31.3)	(90.0)	(98.0)
Other expense	(4.6)	(10.4)	(17.3)	(34.3)
Income before taxes	103.6	59.9	330.6	315.6
Provision for income taxes	29.4	22.5	106.3	121.7
Net income from continuing operations	74.2	37.4	224.3	193.9
Discontinued operations, net of tax	(7.9)	0.2	(8.7)	(2.9)
Net income	66.3	37.6	215.6	191.0
Preferred stock dividends of subsidiary	(0.7)	(0.7)	(2.3)	(2.3)
Noncontrolling interest in subsidiaries	0.1		0.1	
Net income attributed to common shareholders	\$ 65.7	\$ 36.9	\$ 213.4	\$ 188.7
Average shares of common stock				
Basic	78.5	78.7	78.5	78.6
Diluted	79.3	79.2	79.3	78.9
Earnings (loss) per common share (basic)				
Net income from continuing operations	\$ 0.94	\$ 0.47	\$ 2.83	\$ 2.44
Discontinued operations, net of tax	(0.10)		(0.11)	(0.04)
Earnings per common share (basic)	\$ 0.84	\$ 0.47	\$ 2.72	\$ 2.40
Earnings (loss) per common share (diluted)				
Net income from continuing operations	\$ 0.93	\$ 0.47	\$ 2.80	\$ 2.43
Discontinued operations, net of tax	(0.10)		(0.11)	(0.04)

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Earnings per common share (diluted)	\$	0.83	\$	0.47	\$	2.69	\$	2.39
Dividends per common share declared	\$	0.68	\$	0.68	\$	2.04	\$	2.04

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

Table of Contents

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited) (Millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Net income	\$ 66.3	\$ 37.6	\$ 215.6	\$ 191.0
Other comprehensive income, net of tax:				
Cash flow hedges				
Unrealized net gains (losses) arising during period, net of tax of \$0.1 million, \$- million, \$(0.1) million, and \$1.2 million, respectively	0.1	(0.4)	(0.1)	1.5
Reclassification of net losses to net income, net of tax of \$1.0 million, \$0.6 million, \$2.6 million, and \$3.4 million, respectively	1.6	1.3	4.1	5.4
Cash flow hedges, net	1.7	0.9	4.0	6.9
Defined benefit pension plans				
Amortization of pension and other postretirement benefit costs included in net periodic benefit cost, net of tax of \$0.2 million, \$0.2 million, \$0.7 million, and \$0.4 million, respectively	0.4	0.2	1.1	0.7
Other comprehensive income, net of tax	2.1	1.1	5.1	7.6
Comprehensive income	68.4	38.7	220.7	198.6
Preferred stock dividends of subsidiary	(0.7)	(0.7)	(2.3)	(2.3)
Noncontrolling interest in subsidiaries	0.1		0.1	
Comprehensive income attributed to common shareholders	\$ 67.8	\$ 38.0	\$ 218.5	\$ 196.3

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

Table of Contents

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(Millions)

	September 30 2012	December 31 2011
Assets		
Cash and cash equivalents	\$ 18.1	\$ 28.1
Collateral on deposit	51.6	50.9
Accounts receivable and accrued unbilled revenues, net of reserves of \$42.0 and \$47.1, respectively	484.6	737.7
Inventories	320.7	298.0
Assets from risk management activities	158.3	227.2
Regulatory assets	117.6	125.1
Assets held for sale	13.0	26.1
Deferred income taxes	102.7	94.2
Prepaid taxes	129.9	209.6
Other current assets	23.1	29.0
Current assets	1,419.6	1,825.9
Property, plant, and equipment, net of accumulated depreciation of \$3,120.0 and \$3,006.9, respectively	5,473.0	5,177.8
Regulatory assets	1,621.2	1,658.5
Assets from risk management activities	42.7	64.4
Equity method investments	506.7	476.3
Goodwill	658.3	658.4
Other long-term assets	122.8	121.9
Total assets	\$ 9,844.3	\$ 9,983.2
Liabilities and Equity		
Short-term debt	\$ 410.3	\$ 303.3
Current portion of long-term debt	387.0	250.0
Accounts payable	368.1	426.6
Liabilities from risk management activities	192.9	311.5
Accrued taxes	45.5	70.5
Regulatory liabilities	80.3	67.5
Liabilities held for sale	27.4	27.3
Other current liabilities	243.7	217.0
Current liabilities	1,755.2	1,673.7
Long-term debt	1,708.1	1,845.0
Deferred income taxes	1,176.9	1,070.7
Deferred investment tax credits	47.6	44.0
Regulatory liabilities	354.2	332.5
Environmental remediation liabilities	594.9	615.1
Pension and other postretirement benefit obligations	530.5	749.3
Liabilities from risk management activities	61.2	102.0
Asset retirement obligations	413.5	397.2
Other long-term liabilities	139.3	141.1
Long-term liabilities	5,026.2	5,296.9
Commitments and contingencies		
Common stock - \$1 par value; 200,000,000 shares authorized; 78,287,906 shares issued; 77,907,270 shares outstanding	78.3	78.3

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Additional paid-in capital	2,571.5	2,579.1
Retained earnings	417.0	363.6
Accumulated other comprehensive loss	(37.4)	(42.5)
Shares in deferred compensation trust	(17.6)	(17.1)
Total common shareholders equity	3,011.8	2,961.4
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
Total liabilities and equity	\$ 9,844.3	\$ 9,983.2

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

Table of Contents

INTEGRYS ENERGY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited) (Millions)	Nine Months Ended September 30	
	2012	2011
Operating Activities		
Net income	\$ 215.6	\$ 191.0
Adjustments to reconcile net income to net cash provided by operating activities		
Discontinued operations, net of tax	8.7	2.9
Depreciation and amortization expense	187.7	185.3
Recoveries and refunds of regulatory assets and liabilities	12.6	42.8
Net unrealized gains on energy contracts	(42.8)	(18.9)
Bad debt expense	19.3	27.3
Pension and other postretirement expense	46.7	54.1
Pension and other postretirement contributions	(247.8)	(109.7)
Deferred income taxes and investment tax credits	86.8	155.9
Equity income, net of dividends	(13.4)	(11.2)
Other	32.9	24.7
Changes in working capital		
Collateral on deposit	(1.1)	(9.8)
Accounts receivable and accrued unbilled revenues	232.6	295.5
Inventories	(20.9)	(71.4)
Other current assets	66.9	16.3
Accounts payable	(45.1)	(56.3)
Other current liabilities	5.7	(83.8)
Net cash provided by operating activities	544.4	634.7
Investing Activities		
Capital expenditures	(437.8)	(203.2)
Capital contributions to equity method investments	(24.0)	(25.6)
Acquisition of compressed natural gas fueling companies, net of cash acquired	1.3	(42.6)
Other	11.7	4.8
Net cash used for investing activities	(448.8)	(266.6)
Financing Activities		
Short-term debt, net	107.0	240.2
Repayment of notes payable		(10.0)
Issuance of long-term debt	28.0	
Repayment of long-term debt	(28.2)	(556.2)
Proceeds from stock option exercises	54.9	8.0
Shares purchased for stock-based compensation	(85.1)	(10.9)
Payment of dividends		
Preferred stock of subsidiary	(2.3)	(2.3)
Common stock	(159.0)	(153.4)
Payments made on derivative contracts related to divestitures classified as financing activities	(27.9)	(29.3)
Other	0.5	(3.5)
Net cash used for financing activities	(112.1)	(517.4)
Change in cash and cash equivalents - continuing operations	(16.5)	(149.3)
Change in cash and cash equivalents - discontinued operations		
Net cash provided by (used for) operating activities	6.6	(1.2)
Net cash used for investing activities	(0.1)	(0.9)
Net cash used for financing activities		(0.3)
Net change in cash and cash equivalents	(10.0)	(151.7)

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Cash and cash equivalents at beginning of period		28.1		179.0
Cash and cash equivalents at end of period	\$	18.1	\$	27.3

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

Table of Contents

**INTEGRYS ENERGY GROUP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO FINANCIAL STATEMENTS**

September 30, 2012

NOTE 1 FINANCIAL INFORMATION

As used in these notes, the term "financial statements" refers to the condensed consolidated financial statements. This includes the condensed consolidated statements of income, condensed consolidated statements of comprehensive income, condensed consolidated balance sheets, and condensed consolidated statements of cash flows, unless otherwise noted. In this report, when we refer to "us," "we," "our," or "ours," we are referring to Integrys Energy Group, Inc.

We prepare our financial statements in conformity with the rules and regulations of the SEC for Quarterly Reports on Form 10-Q and in accordance with GAAP. Accordingly, these financial statements do not include all of the information and footnotes required by GAAP for annual financial statements. These financial statements should be read in conjunction with the consolidated financial statements and footnotes in our Annual Report on Form 10-K for the year ended December 31, 2011.

In management's opinion, these unaudited financial statements include all adjustments necessary for a fair presentation of financial results. All adjustments are normal and recurring, unless otherwise noted. All intercompany transactions have been eliminated in consolidation. Financial results for an interim period may not give a true indication of results for the year.

Reclassification

We reclassified \$49.0 million of materials and supplies reported in other current assets at December 31, 2011, to inventories to be consistent with the current period presentation on the balance sheets. We adjusted changes in working capital on the statements of cash flows by reclassifying \$10.1 million related to materials and supplies at September 30, 2011, from the change in other current assets line item to the change in inventories line item. This reclassification had no impact on total cash flows from operating activities.

NOTE 2 CASH AND CASH EQUIVALENTS

Short-term investments with an original maturity of three months or less are reported as cash equivalents.

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

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

(Millions)	Nine Months Ended September 30			
	2012		2011	
Cash paid for interest	\$	60.0	\$	80.3
Cash received for income taxes		(45.7)		(10.9)

Significant noncash transactions were:

(Millions)	Nine Months Ended September 30			
	2012		2011	
Construction costs funded through accounts payable	\$	78.8	\$	34.1
Equity issued for stock-based compensation plans				15.8
Equity issued for reinvested dividends				5.4

Table of Contents**NOTE 3 RISK MANAGEMENT ACTIVITIES**

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

(Millions)	Balance Sheet Presentation *	September 30, 2012	
		Assets from Risk Management Activities	Liabilities from Risk Management Activities
Utility Segments			
Non-hedge derivatives			
Natural gas contracts	Current	\$ 9.4	\$ 17.1
Natural gas contracts	Long-term	1.7	1.3
Financial transmission rights (FTRs)	Current	3.4	0.2
Petroleum product contracts	Current	0.3	
Coal contract	Current		5.0
Coal contract	Long-term		4.3
Cash flow hedges			
Natural gas contracts	Current		0.5
Nonregulated Segments			
Non-hedge derivatives			
Natural gas contracts	Current	70.7	67.0
Natural gas contracts	Long-term	15.6	11.6
Electric contracts	Current	74.5	103.0
Electric contracts	Long-term	25.4	44.1
Foreign exchange contracts	Current	0.1	0.1
	Current	158.4	192.9
	Long-term	42.7	61.3
Total		\$ 201.1	\$ 254.2

* 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 upon the maturities of the underlying contracts.

Table of Contents

(Millions)	December 31, 2011		
	Balance Sheet Presentation *	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
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 upon the maturities of the underlying contracts.

The tables above include amounts that were classified as held for sale at Integrys Energy Services. The carrying values of our assets and liabilities from risk management activities that were classified as held for sale are shown in the table below. See Note 5, *Discontinued Operations*, for more information.

(Millions)	September 30, 2012	December 31, 2011
Nonregulated Segments		
Non-hedge derivatives		
Electric contracts		
Current assets from risk management activities	\$ 0.1	\$
Current liabilities from risk management activities		0.1
Long-term liabilities from risk management activities	0.1	

The following table shows our cash collateral positions:

(Millions)	September 30, 2012	December 31, 2011
------------	--------------------	-------------------

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Cash collateral provided to others	\$	51.6	\$	50.9
Cash collateral received from others *		0.6		2.3

* 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)	September 30, 2012	December 31, 2011
IntegrYS Energy Services	\$ 112.0	\$ 193.8
Utility segments	15.3	39.1

Table of Contents

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)	September 30, 2012	December 31, 2011
Collateral that would have been required:		
Integrys Energy Services	\$ 171.5	\$ 272.3
Utility segments	9.9	28.7
Collateral already satisfied:		
Integrys Energy Services Letters of credit	2.2	11.0
Collateral remaining:		
Integrys Energy Services	169.3	261.3
Utility segments	9.9	28.7

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:

	September 30, 2012		December 31, 2011	
	Purchases	Other Transactions	Purchases	Other Transactions
Natural gas (millions of therms)	1,044.1	N/A	1,122.7	N/A
FTRs (millions of kilowatt-hours)	N/A	6,507.6	N/A	5,077.5
Petroleum products (barrels)	61,814.0	N/A	46,872.0	N/A
Coal contract (millions of tons)	3.5	N/A	4.1	N/A

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

(Millions)	Financial Statement Presentation	Three Months Ended		Nine Months Ended	
		September 30 2012	September 30 2011	September 30 2012	September 30 2011
Natural gas contracts	Balance Sheet Regulatory assets (current)	\$ 10.2	\$ (9.3)	\$ 22.9	\$ 4.1

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Natural gas contracts	Balance Sheet	Regulatory assets (long-term)	3.8	(2.5)	7.7	(2.3)
Natural gas contracts	Balance Sheet	Regulatory liabilities (current)	(3.4)	(0.1)	(2.9)	(0.2)
Natural gas contracts	Balance Sheet	Regulatory liabilities (long-term)	0.8		1.3	
Natural gas contracts	Income Statement	Utility cost of fuel, natural gas, and purchased power	0.1	(0.1)	0.2	
Natural gas contracts	Income Statement	Operating and maintenance expense	0.1		0.1	
FTRs	Balance Sheet	Regulatory assets (current)		0.5	(0.4)	(1.0)
FTRs	Balance Sheet	Regulatory liabilities (current)	(0.2)	(0.6)	0.5	(0.7)
Petroleum product contracts	Balance Sheet	Regulatory assets (current)	0.2		0.1	(0.1)
Petroleum product contracts	Balance Sheet	Regulatory liabilities (current)	0.1	(0.2)	0.1	
Petroleum product contracts	Income Statement	Operating and maintenance expense	0.1	(0.2)	0.1	
Coal contract	Balance Sheet	Regulatory assets (current)	0.7	1.1	(2.5)	0.9
Coal contract	Balance Sheet	Regulatory assets (long-term)	(0.1)	2.4	0.1	(0.6)
Coal contract	Balance Sheet	Regulatory liabilities (long-term)		0.5		(3.2)

Nonregulated Segments

Non-Hedge Derivatives

IntegrYS Energy Services enters into derivative contracts such as futures, forwards, options, and swaps that are used to manage commodity price risk primarily associated with retail electric and natural gas customer contracts.

Table of Contents

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

(Millions)	September 30, 2012		December 31, 2011	
	Purchases	Sales	Purchases	Sales
Commodity contracts				
Natural gas (therms)	934.0	720.9	959.2	797.1
Electric (kilowatt-hours)	39,962.4	24,162.7	34,405.7	20,374.0
Foreign exchange contracts (Canadian dollars)	1.3	1.3	4.2	4.2

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

(Millions)	Income Statement Presentation	Three Months Ended September 30		Nine Months Ended September 30	
		2012	2011	2012	2011
Natural gas contracts	Nonregulated revenue	\$ (4.4)	\$ 4.9	\$ 7.0	\$ 19.2
Natural gas contracts	Nonregulated revenue (reclassified from accumulated OCI) *	(0.1)	(0.2)	(1.6)	(0.6)
Electric contracts	Nonregulated revenue	49.1	(1.6)	(10.5)	(5.5)
Electric contracts	Nonregulated revenue (reclassified from accumulated OCI) *	(1.9)	(1.2)	(3.3)	(1.0)
Total		\$ 42.7	\$ 1.9	\$ (8.4)	\$ 12.1

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

In the next 12 months, pre-tax losses of \$0.6 million and \$4.1 million related to 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 customer contracts.

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.

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 contracts.

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

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

(Millions)	Unrealized Gain (Loss) Recognized in OCI on Derivative Instruments (Effective Portion)	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Natural gas contracts	\$	\$ (2.3)
Electric contracts		3.8
Total	\$	\$ 1.5

(Millions)	Income Statement Presentation	Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			
		Three Months Ended September 30		Nine Months Ended September 30	
		2012	2011	2012	2011
Settled/Realized					
Natural gas contracts	Nonregulated revenue	\$	\$	\$	\$ (9.3)
Electric contracts	Nonregulated revenue				4.2
Interest rate swaps *	Interest expense	(0.2)	(0.2)	(0.8)	(0.8)
Hedge Designation Discontinued					
Natural gas contracts	Nonregulated revenue				(0.3)
Interest rate swaps	Interest expense				(0.2)
Total		\$ (0.2)	\$ (0.2)	\$ (0.8)	\$ (6.4)

* In May 2010, we entered into interest rate swaps that were designated as cash flow hedges to hedge the variability in forecasted interest payments on a debt issuance. These swaps were terminated when the related debt was issued in November 2010. Amounts remaining in accumulated OCI are being reclassified to interest expense over the life of the related debt.

Table of Contents

Gain (Loss) Recognized in Income on Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing)			
		Three Months Ended	Nine Months Ended
		September 30	September 30
(Millions)	Income Statement Presentation	2011	2011
Natural gas contracts	Nonregulated revenue	\$	\$ 0.3
Electric contracts	Nonregulated revenue		(0.3)
Total		\$	\$

NOTE 4 AGREEMENT TO PURCHASE FOX ENERGY CENTER

In September 2012, WPS entered into an agreement to acquire all of the equity interests in Fox Energy Company LLC. The purchase includes the Fox Energy Center, a 593-megawatt combined-cycle electric generating facility in Wisconsin, along with associated contracts. WPS currently supplies natural gas for the facility and purchases 500 megawatts of capacity and the associated energy output under a tolling arrangement.

WPS will pay \$390.0 million to purchase Fox Energy Company LLC, subject to post-closing adjustments primarily related to working capital. In addition, WPS will pay \$50.0 million to terminate the existing tolling arrangement immediately prior to the acquisition of the facility. The purchase will be financed initially with a combination of short-term debt and cash flow from operations. This short-term debt will be replaced later in 2013 with long-term financing.

Fox Energy Center is a dual-fuel facility, equipped to use fuel oil, but expected to run primarily on natural gas. This plant will give WPS a more balanced mix of electric generation, including coal, natural gas, hydroelectric, wind, and other renewable sources.

The transaction is subject to state regulatory approvals, including cost recovery, FERC approvals, and the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. The transaction is expected to close on or around April 1, 2013.

NOTE 5 DISCONTINUED OPERATIONS**IntegrYS Energy Services Segment***Pending Sale of WPS Westwood Generation, LLC*

In September 2012, Sunbury Holdings, LLC, a subsidiary of IntegrYS Energy Services, entered into a definitive agreement to sell all of the membership interests of WPS Westwood Generation, LLC (Westwood), owner of a waste coal generation plant located in Pennsylvania. The

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

cash proceeds related to the sale are estimated to be \$2.2 million, subject to certain post-closing adjustments primarily related to working capital. The agreement also includes a \$4.0 million note receivable from the buyer with a seven and one-half year term. Integrys Energy Services recorded a pre-tax impairment loss of \$8.4 million (\$5.0 million after tax) related to Westwood during the third quarter of 2012 when the assets and liabilities were classified as held for sale. Other gains or losses may be recognized related to adjustments to selling costs at closing, as well as changes in the fair value of financial instruments included in the sale. Deferred financing costs of \$0.4 million will also be written off to the gain or loss on sale when the related bonds are repaid, as discussed below. The transaction is expected to close in November 2012.

In connection with the sale, Integrys Energy Services repaid \$27.0 million of Refunding Tax Exempt Bonds to Schuylkill County Industrial Development Authority in November 2012. The bonds were required to be repaid prior to the closing of the sale transaction because the Westwood assets were a substantial portion of the collateral on these borrowings. See Note 10, *Long-term Debt*, for more information regarding this repayment.

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Table of Contents

The carrying values of the major classes of assets and liabilities classified as held for sale on the balance sheets were as follows:

(Millions)	September 30, 2012	December 31, 2011
Inventories	\$ 1.0	\$ 1.1
Current assets from risk management activities	0.1	
Property, plant, and equipment, net of accumulated depreciation of \$ - and \$10.9, respectively	5.5	14.1
Other long-term assets	1.1	1.2
Total assets	\$ 7.7	\$ 16.4
Current liabilities from risk management activities	\$	\$ 0.1
Other current liabilities	0.1	0.2
Long-term debt	27.0	27.0
Long-term liabilities from risk management activities	0.1	
Total liabilities	\$ 27.2	\$ 27.3

A summary of the components of discontinued operations related to Westwood recorded in the income statements for the three and nine months ended September 30 is as follows:

(Millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Nonregulated revenues	\$ 2.2	\$ 3.1	\$ 8.2	\$ 7.9
Nonregulated cost of sales	(1.2)	(1.4)	(3.6)	(4.0)
Operating and maintenance expense	(0.9)	(0.9)	(4.5)	(4.8)
Impairment losses	(8.4)		(8.4)	
Depreciation and amortization expense	(0.3)	(0.4)	(1.0)	(1.1)
Taxes other than income taxes	(0.1)	(0.1)	(0.2)	(0.2)
Interest expense	(0.1)	(0.1)	(0.4)	(0.4)
Income (loss) before taxes	(8.8)	0.2	(9.9)	(2.6)
(Provision) benefit for income taxes	3.5	(0.1)	3.9	0.9
Discontinued operations, net of tax	\$ (5.3)	\$ 0.1	\$ (6.0)	\$ (1.7)

Integrys Energy Services will receive interest income for seven and one-half years related to the note receivable from the buyer. The sale will also generate immaterial cash flows from providing certain administrative transition services for up to a six-month period following the sale. However, Integrys Energy Services will not have the ability to significantly influence the operating or financial policies of Westwood and will also not have significant continuing involvement in the operations of Westwood after it is sold. Therefore, the continuing cash flows discussed above will not be considered direct cash flows of Westwood, and classification as a discontinued operation is appropriate.

Pending Sale of WPS Beaver Falls Generation, LLC and WPS Syracuse Generation, LLC

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

In October 2012, WPS Empire State, Inc, a subsidiary of Integrys Energy Services, entered into a definitive agreement to sell all of the membership interests of WPS Beaver Falls Generation, LLC (Beaver Falls) and WPS Syracuse Generation, LLC (Syracuse), both of which own natural gas-fired generation plants located in the state of New York. The closing of this sale is contingent upon obtaining certain customary contractual consents and necessary regulatory approvals. The proceeds from the sale are estimated to be \$1.8 million, subject to certain post-closing adjustments primarily related to working capital. The sale agreement also includes a potential annual payment to Integrys Energy Services for a four-year period following the sale based on a certain level of earnings achieved by the buyer (an earn-out). Integrys Energy Services recorded a pre-tax impairment loss of \$4.0 million (\$2.4 million after tax) related to Beaver Falls and Syracuse during the third quarter of 2012 when the assets and liabilities were classified as held for sale. Other gains or losses may be recognized related to adjustments to selling costs at closing, as well as changes in the fair value of financial instruments included in the sale. The transaction is expected to close by the end of the first quarter of 2013.

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Table of Contents

The carrying values of the major classes of assets and liabilities classified as held for sale on the balance sheets were as follows:

(Millions)	September 30, 2012	December 31, 2011
Inventories	\$ 2.2	\$ 2.2
Other current assets	0.2	0.2
Property, plant, and equipment, net of accumulated depreciation of \$ - and \$0.9, respectively	2.8	7.2
Other long-term assets	0.1	0.1
Total assets	\$ 5.3	\$ 9.7
Total liabilities other current liabilities	\$ 0.2	\$

A summary of the components of discontinued operations related to Beaver Falls and Syracuse recorded in the income statements for the three and nine months ended September 30 is as follows:

(Millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Nonregulated revenues	\$ 1.2	\$ 2.0	\$ 1.5	\$ 4.8
Nonregulated cost of sales	(0.7)	(0.8)	(1.6)	(2.0)
Operating and maintenance expense	(0.6)	(0.6)	(1.7)	(2.3)
Impairment losses	(4.0)		(4.0)	
Depreciation and amortization expense	(0.2)	(0.2)	(0.6)	(0.5)
Taxes other than income taxes		(0.2)	(1.1)	(0.7)
Income (loss) before taxes	(4.3)	0.2	(7.5)	(0.7)
(Provision) benefit for income taxes	1.7	(0.1)	3.0	0.3
Discontinued operations, net of tax	\$ (2.6)	\$ 0.1	\$ (4.5)	\$ (0.4)

The sale of Beaver Falls and Syracuse will generate immaterial cash flows from providing certain administrative transition services for up to a six-month period following the sale and from a potential four-year earn-out payment. However, Integrys Energy Services will not have the ability to significantly influence the operating or financial policies of Beaver Falls and Syracuse and will also not have significant continuing involvement in the operations of Beaver Falls and Syracuse after they are sold. Therefore, the continuing cash flows discussed above will not be considered direct cash flows of Beaver Falls and Syracuse, and classification as a discontinued operation is appropriate.

Sale of Energy Management Consulting Business

During the nine months ended September 30, 2011, Integrys Energy Services recorded a \$0.1 million after-tax gain in discontinued operations when contingent payments were earned related to the 2009 sale of its energy management consulting business.

Holding Company and Other Segment

Discontinued operations were also recorded at the holding company and other segment. Uncertain tax positions included in our liability for unrecognized tax benefits were remeasured to better reflect how the underlying positions are resolving themselves in various taxing jurisdictions. We also effectively settled certain state income tax examinations in 2012. During the nine months ended September 30, 2012 and September 30, 2011, we recorded a \$1.8 million after-tax gain and a \$0.9 million after-tax loss, respectively, in discontinued operations.

NOTE 6 INVESTMENT IN ATC

Our electric transmission investment segment consists of WPS Investments LLC's ownership interest in ATC, which was approximately 34% at September 30, 2012. 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.

Table of Contents

The following table shows changes to our investment in ATC.

(Millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Balance at the beginning of period	\$ 456.4	\$ 429.4	\$ 439.4	\$ 416.3
Add: Equity in net income	21.7	19.9	63.8	59.0
Add: Capital contributions	8.5	2.6	17.0	8.5
Less: Dividends received	17.3	16.2	50.9	48.1
Balance at the end of period	\$ 469.3	\$ 435.7	\$ 469.3	\$ 435.7

Financial data for all of ATC is included in the following tables:

(Millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Income statement data				
Revenues	\$ 150.3	\$ 142.8	\$ 450.1	\$ 420.6
Operating expenses	68.8	66.4	210.1	192.5
Other expense	21.0	19.8	62.1	61.6
Net income *	\$ 60.5	\$ 56.6	\$ 177.9	\$ 166.5

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

(Millions)	September 30, 2012	December 31, 2011
Balance sheet data		
Current assets	\$ 58.2	\$ 58.7
Noncurrent assets	3,237.0	3,053.7
Total assets	\$ 3,295.2	\$ 3,112.4
Current liabilities	\$ 232.0	\$ 298.5
Long-term debt	1,550.0	1,400.0
Other noncurrent liabilities	93.9	82.6
Members' equity	1,419.3	1,331.3
Total liabilities and members' equity	\$ 3,295.2	\$ 3,112.4

NOTE 7 INVENTORIES

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

PGL and NSG price natural gas storage injections at the calendar year average of the cost of natural gas supply purchased. Withdrawals from storage are priced on the LIFO cost method. For interim periods, the difference between current projected replacement cost and the LIFO cost for quantities of natural gas temporarily withdrawn from storage is recorded as a temporary LIFO liquidation debit or credit. At September 30, 2012, all LIFO layers were replenished and the LIFO liquidation balance was zero.

NOTE 8 GOODWILL AND OTHER INTANGIBLE ASSETS

We had no material changes to the carrying amount of goodwill during the nine months ended September 30, 2012, and 2011. Annual impairment tests were completed at all of our reporting units that carried a goodwill balance in the second quarter of 2012, and no impairments resulted from these tests.

Table of Contents

The identifiable intangible assets other than goodwill listed below are part of other current and long-term assets on the Balance Sheets. An insignificant amount was recorded as assets held for sale on the Balance Sheets.

(Millions)	September 30, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets						
Customer-related (1)	\$ 22.4	\$ (14.3)	\$ 8.1	\$ 34.5	\$ (24.8)	\$ 9.7
Electric contract assets (2)				7.8	(6.6)	1.2
Patents (3)	7.2	(0.2)	7.0	7.2		7.2
Compressed natural gas fueling contract assets (4)	5.6	(1.1)	4.5	5.6	(0.3)	5.3
Renewable energy credits (5)	3.2		3.2	2.8		2.8
Nonregulated easements (6)	3.8	(0.8)	3.0	3.8	(0.7)	3.1
Customer-owned equipment modifications (7)	3.9	(0.5)	3.4	3.6	(0.2)	3.4
Emission allowances (8)	0.8	(0.1)	0.7	1.7	(0.2)	1.5
Other	0.9	(0.3)	0.6	1.4	(0.3)	1.1
Total	\$ 47.8	\$ (17.3)	\$ 30.5	\$ 68.4	\$ (33.1)	\$ 35.3
Unamortized intangible assets						
MGU trade name	\$ 5.2		\$ 5.2	\$ 5.2		\$ 5.2
Trillium trade name	3.5		3.5	3.5		3.5
Pinnacle trade name	1.5		1.5	1.5		1.5
Total intangible assets	\$ 58.0	\$ (17.3)	\$ 40.7	\$ 78.6	\$ (33.1)	\$ 45.5

(1) Represents customer relationship assets associated with PELLC's former nonregulated retail natural gas and electric operations, MERC's nonutility ServiceChoice business, and Trillium USA (Trillium) and Pinnacle CNG Systems (Pinnacle) compressed natural gas fueling operations. The remaining weighted-average amortization period for customer-related intangible assets at September 30, 2012, was approximately 10 years.

(2) Represents electric customer contracts acquired in exchange for risk management assets.

(3) Represents 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 September 30, 2012, was approximately 17 years.

(4) Represents the fair value of Trillium and Pinnacle compressed natural gas customer fueling contracts acquired in September 2011. The remaining amortization period at September 30, 2012, was approximately 8 years.

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

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

- (6) Relates to easements supporting a pipeline at Integrys Energy Services. The easements are amortized on a straight-line basis, with a remaining amortization period at September 30, 2012, of approximately 12 years.

- (7) Relates to modifications made by Integrys Energy Services and Trillium to customer-owned equipment. These intangible assets are amortized on a straight-line basis, with a remaining weighted-average amortization period at September 30, 2012, of approximately 12 years.

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

Amortization expense recorded as a component of nonregulated cost of sales in the statements of income was \$0.3 million and \$0.2 million for the three months ended September 30, 2012, and 2011, respectively. Amortization expense for the nine months ended September 30, 2012, and 2011, was \$2.2 million and \$0.8 million, respectively.

Amortization expense recorded as a component of depreciation and amortization expense in the statements of income for the three months ended September 30, 2012, and 2011, was \$0.5 million and \$0.8 million, respectively. Amortization expense for the nine months ended September 30, 2012, and 2011, was \$2.0 million and \$2.5 million, respectively.

An insignificant amount of amortization expense was recorded in discontinued operations for the three and nine months ended September 30, 2012, and 2011.

Table of Contents

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

(Millions)	For the year ending December 31					
	2012	2013	2014	2015	2016	
Amortization recorded in nonregulated cost of sales	\$ 5.7	\$ 1.6	\$ 1.2	\$ 1.1	\$ 0.9	
Amortization recorded in depreciation and amortization expense	2.5	2.0	1.7	1.7	1.5	

NOTE 9 SHORT-TERM DEBT AND LINES OF CREDIT

Our short-term borrowings were as follows:

(Millions, except percentages)	September 30, 2012	December 31, 2011
Commercial paper outstanding	\$ 410.3	\$ 303.3
Average discount rate on outstanding commercial paper	0.35%	0.31%

The commercial paper outstanding at September 30, 2012, had maturity dates ranging from October 1, 2012, through October 24, 2012.

The table below presents our average amount of short-term borrowings outstanding based on daily outstanding balances during the nine months ended September 30:

(Millions)	2012	2011
Average amount of commercial paper outstanding	\$ 299.2	\$ 102.2
Average amount of short-term notes payable outstanding		4.8

We manage our liquidity by maintaining adequate external financing commitments. The information in the table below relates to our revolving credit facilities used to support our commercial paper borrowing program, including remaining available capacity under these facilities:

(Millions)	Maturity	September 30, 2012	December 31, 2011
Revolving credit facility (IntegrYS Energy Group) (1)	04/23/13	\$ 735.0	\$ 735.0
Revolving credit facility (IntegrYS Energy Group)	05/17/14	275.0	275.0
Revolving credit facility (IntegrYS Energy Group)	05/17/16	200.0	200.0
Revolving credit facility (IntegrYS Energy Group)	06/13/17	635.0	

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Revolving credit facility (WPS) (1)	04/23/13		115.0
Revolving credit facility (WPS) (2)	06/12/13	115.0	
Revolving credit facility (WPS)	05/17/14	135.0	135.0
Revolving credit facility (PGL) (1)	04/23/13		250.0
Revolving credit facility (PGL)	06/13/17	250.0	
Total short-term credit capacity		\$ 1,610.0	\$ 1,710.0
Less:			
Letters of credit issued inside credit facilities		\$ 24.4	\$ 33.7
Commercial paper outstanding		410.3	303.3
Available capacity under existing agreements		\$ 1,175.3	\$ 1,373.0

(1) These credit facilities were terminated in June 2012.

(2) WPS requested approval from the PSCW to extend this facility through June 13, 2017.

In connection with the pending purchase of Fox Energy Company LLC, WPS requested approval from the PSCW to temporarily increase its short-term debt limit. See Note 4, *Agreement to Purchase Fox Energy Center*, for more information regarding this pending purchase.

Table of Contents**NOTE 10 LONG-TERM DEBT**

(Millions)	September 30, 2012	December 31, 2011
WPS (1)	\$ 722.1	\$ 722.1
PGL (2)	525.0	525.0
NSG (3)	74.5	74.7
IntegrYS Energy Group (4)	774.8	774.8
Other term loan (5)	27.0	27.0
Total	2,123.4	2,123.6
Unamortized discount	(1.3)	(1.6)
Total debt	2,122.1	2,122.0
Less current portion	(387.0)	(250.0)
Less long-term debt held for sale (5)	(27.0)	(27.0)
Total long-term debt	\$ 1,708.1	\$ 1,845.0

(1) 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 the current portion of long-term debt on our balance sheets.

In February 2013, WPS's 3.95% Senior Notes will mature. As a result, the \$22.0 million balance of these notes was included in the current portion of long-term debt on our September 30, 2012 balance sheet.

(2) In May 2013, PGL's 4.625% Series NN-2 Fixed First and Refunding Mortgage Bonds will mature. As a result, the \$75.0 million balance of these bonds was included in the current portion of long-term debt on our September 30, 2012 balance sheet.

(3) In April 2012, NSG bought back its \$28.2 million of 5.00% Series M First Mortgage Bonds that were due December 1, 2028.

In the same month, NSG issued \$28.0 million of 3.43% Series P First Mortgage Bonds. These bonds are due April 1, 2027.

In May 2013, NSG's 4.625% Series N-2 First Mortgage Bonds will mature. As a result, the \$40.0 million balance of these bonds was included in the current portion of long-term debt on our September 30, 2012 balance sheet.

(4) In December 2012, our 5.375% Unsecured Senior Notes will mature. As a result, the \$100.0 million balance of these notes was included in the current portion of long-term debt on our balance sheets.

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

(5) This loan was repaid in November 2012 in connection with the pending sale of WPS Westwood Generation, LLC. As a result, the \$27.0 million balance of this loan was included in liabilities held for sale on our balance sheets. See Note 5, *Discontinued Operations*, for more information regarding the pending sale. This loan had a floating interest rate that was reset weekly. At September 30, 2012, the interest rate was 0.19%.

In October 2012, PGL secured commitments for \$100.0 million of 30-year 3.98% Series YY First and Refunding Mortgage Bonds with a delayed draw feature. These bonds will be issued in December 2012.

NOTE 11 INCOME TAXES

We calculate our interim period provision for income taxes based on our projected annual effective tax rate as adjusted for certain discrete items.

The table below shows our effective tax rates:

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Effective Tax Rate	28.4%	37.6%	32.2%	38.6%

Table of Contents

Our effective tax rate normally differs from the federal statutory tax rate of 35% due to additional provision for multistate income tax obligations. Other significant items that had an impact on our effective tax rates are noted below.

Our effective tax rate for the three months ended September 30, 2012, was impacted by a \$5.9 million decrease in the provision for income taxes resulting from WPS's 2013 rate case settlement agreement. In the third quarter of 2012, WPS recorded a regulatory asset after the settlement agreement authorized recovery of deferred income taxes expensed in previous years in connection with the 2010 federal health care reform. See Note 20, *Regulatory Environment*, for more information. Our effective tax rate was also impacted by the federal income tax benefit of tax credits related to wind production and other miscellaneous tax adjustments.

Our effective tax rate for the nine months ended September 30, 2012, was impacted by the settlement of certain state income tax examinations and the remeasurement of uncertain tax positions included in our liability for unrecognized tax benefits in 2012. We decreased our provision for income taxes \$6.2 million in 2012 primarily related to the effective settlement and remeasurement of these positions. Finally, our provision for income taxes decreased \$5.9 million in 2012 related to the impact of WPS's 2013 rate case settlement agreement, as described above. Our effective tax rate was also impacted by the federal income tax benefit of tax credits related to wind production.

Our effective tax rate for the nine months ended September 30, 2011, was impacted by the federal income tax benefit of tax credits related to wind production and tax law changes in Michigan and Wisconsin. We recorded \$6.0 million of income tax expense in 2011 when we increased our deferred income tax liabilities related to these tax law changes.

During the three months ended September 30, 2012, there was not a significant change in our liability for unrecognized tax benefits. During the nine months ended September 30, 2012, we decreased our liability for unrecognized tax benefits by \$8.3 million. This decrease related to the effective settlement of certain state income tax examinations and a remeasurement of uncertain tax positions, as described above. We reduced the provision for income taxes related to these items, of which a portion was reported as discontinued operations.

NOTE 12 COMMITMENTS AND CONTINGENCIES

Commodity Purchase Obligations and Purchase Order Commitments

We and our subsidiaries routinely enter into long-term purchase and sale commitments for various quantities and lengths of time. The regulated natural gas utilities have obligations to distribute and sell natural gas to their customers, and the regulated electric utilities have obligations to distribute and sell electricity to their customers. The utilities expect to recover costs related to these obligations in future customer rates. Additionally, the majority of the energy supply contracts entered into by Integrys Energy Services are to meet its obligations to deliver energy to customers.

The purchase obligations described below were as of September 30, 2012.

- The electric utility segment had obligations of \$1,018.3 million for either capacity or energy related to purchased power that extend through 2029, obligations of \$165.4 million related to coal supply and transportation contracts that extend through 2017, and obligations of \$0.9 million for other commodities that extend through 2013.
- The natural gas utility segment had obligations of \$773.4 million related to natural gas supply and transportation contracts that extend through 2028.
- Integrys Energy Services had obligations of \$268.5 million, primarily related to electricity and natural gas supply contracts that extend through 2020.
- We and our subsidiaries also had commitments of \$410.3 million in the form of purchase orders issued to various vendors that relate to normal business operations, including construction projects.

Environmental

Clean Air Act (CAA) New Source Review Issues

Weston and Pulliam Plants:

In November 2009, the EPA issued a Notice of Violation (NOV) to WPS alleging violations of the CAA's New Source Review requirements relating to certain projects completed at the Weston and Pulliam plants from 1994 to 2009.

In May 2010, WPS received from the Sierra Club a Notice of Intent (NOI) to file a civil lawsuit based on allegations that WPS violated the CAA at the Weston and Pulliam plants. WPS entered into a Standstill Agreement with the Sierra Club by which the parties agreed to negotiate as part of the EPA NOV process, rather than litigate. The Standstill Agreement ended on October 6, 2012, but further action by the Sierra Club is unknown at this time.

Table of Contents

WPS believes it has reached a tentative agreement with the EPA on general terms to settle these air permitting violation claims and is negotiating a consent decree based upon those general terms, which are subject to change during the negotiations. Based upon the status of the current negotiations and a review of existing EPA consent decrees, WPS anticipates that the final consent decree could include the installation of emission control technology, changed operating conditions (including fuels other than coal and retirement of units), limitations on emissions, beneficial supplemental environmental projects, and a civil fine. Once the final terms are agreed to, the U.S. District Court must approve the consent decree after a public comment process.

WPS cannot predict the final outcome of this matter because a final agreement on the consent decree may not be reached, the final terms of the consent decree may be different than currently anticipated, interveners could convince the court to make changes to the terms of the consent decree during the public comment process, or the court may not approve the final consent decree.

Any costs prudently incurred as a result of actions taken due to the consent decree are expected to be recoverable from customers. We are currently unable to estimate the possible loss or range of loss related to this matter.

Columbia and Edgewater Plants:

In December 2009, the EPA issued an NOV to Wisconsin Power and Light (WP&L), the operator of the Columbia and Edgewater plants, and the other joint owners of these plants (including WPS). The NOV alleges violations of the CAA's New Source Review requirements related to certain projects completed at those plants.

In September 2010, the Sierra Club filed a lawsuit against WP&L, which included allegations that modifications made at the Columbia plant did not comply with the CAA. The case has been dismissed without prejudice as the parties continue to participate in settlement negotiations.

Also in September 2010, the Sierra Club filed a lawsuit against WP&L, which included allegations that modifications made at the Edgewater plant did not comply with the CAA. The case was stayed until July 15, 2012, and a request was made by WP&L to further extend the stay and all deadlines. An update was filed with the court on August 31, 2012, regarding the settlement negotiations with the Sierra Club, the EPA, and the joint owners of the Edgewater plant.

WPS, WP&L, and Madison Gas and Electric (Joint Owners), along with the EPA and the Sierra Club (collectively, the Parties) are exploring settlement options. The Joint Owners believe that the Parties have reached a tentative agreement on general terms to settle these air permitting violation claims and are negotiating a consent decree based upon those general terms, which are subject to change during the negotiations. Based upon the status of the current negotiations and a review of existing EPA consent decrees, WPS anticipates that the final consent decree could include the installation of emission control technology, changed operating conditions (including fuels other than coal and retirement of units), limitations on emissions, beneficial supplemental environmental projects, and a civil fine. Once the Parties agree to the final terms, the U.S. District Court must approve the consent decree after a public comment process.

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

WPS cannot predict the final outcome of this matter because the Parties may be unable to reach a final agreement on the consent decree, the final terms of the consent decree may be different than currently anticipated, interveners could convince the court to make changes to the terms of the consent decree during the public comment process, or the court may not approve the final consent decree.

Any costs prudently incurred as a result of actions taken due to the consent decree are expected to be recoverable from customers. We are currently unable to estimate the possible loss or range of loss related to this matter.

Weston Air Permits

Weston 4 Construction Permit:

From 2004 to 2009, the Sierra Club filed various petitions objecting to the construction permit issued for the Weston 4 plant. In June 2010, the Wisconsin Court of Appeals affirmed the Weston 4 construction permit, but directed the WDNR to reopen the permit to set specific visible emissions limits. In July 2010, the WDNR, WPS, and the Sierra Club filed Petitions for Review with the Wisconsin Supreme Court. In March 2011, the Wisconsin Supreme Court denied all Petitions for Review. Other than the specific visible emissions limits issue, all other challenges to the construction permit are now resolved. WPS is working with the WDNR and the Sierra Club to resolve this issue. We do not expect this matter to have a material impact on our financial statements.

Table of Contents

Weston Title V Air Permit:

In November 2010, the WDNR provided a draft revised permit. WPS objected to proposed changes in mercury limits and requirements on the boilers as beyond the authority of the WDNR. WPS and the WDNR continue to meet to resolve these issues. In September 2011, the WDNR issued an updated draft revised permit and a request for public comments. Due to the significance of the changes to the draft permit, the WDNR intends to re-issue the draft permit for additional comments. On July 24, 2012, Clean Wisconsin filed suit against the WDNR alleging failure to issue or delay in issuing the Weston 4 Title V permit. WPS is not a party to this litigation, but filed a request for intervention to protect its interests. Motions regarding intervention and dismissal have also been filed by WPS and the WDNR. We do not expect this matter to have a material impact on our financial statements.

WDNR Issued NOVs:

Since 2008, WPS received four NOVs from the WDNR alleging various violations of the different air permits for the entire Weston plant, Weston 1, Weston 2, and Weston 4, as well as one NOV for a clerical error involving pages missing from a quarterly report for Weston. Corrective actions have been taken for the events in the five NOVs. In December 2011, the WDNR dismissed two of the NOVs and referred the other three NOVs to the state Justice Department for enforcement. WPS and the Justice Department have begun discussing the pending NOVs and their resolution. We do not expect this matter to have a material impact on our financial statements.

Pulliam Title V Air Permit

The WDNR issued the renewal of the permit for the Pulliam plant in April 2009. In June 2010, the EPA issued an order directing the WDNR to respond to comments raised by the Sierra Club in its June 2009 Petition requesting the EPA to object to the permit.

WPS also challenged the permit in a contested case proceeding and Petition for Judicial Review. The Petition was dismissed in an order remanding the matter to the WDNR. In February 2011, the WDNR granted a contested case proceeding before an Administrative Law Judge on the issues raised by WPS, which included seeking averaging times in the emission limits in the permit. WPS participated in the contested case proceeding in October 2011. In December 2011, the Administrative Law Judge did not require the WDNR to insert averaging times, for which WPS had argued. WPS has decided not to appeal.

In October 2010, WPS received from the Sierra Club a copy of an NOI to file a civil lawsuit against the EPA based on what the Sierra Club alleged to be an unreasonable delay in responding to the June 2010 order. WPS received notification that the Sierra Club filed suit against the EPA in April 2011. WPS is not a party to this litigation, but intervened to protect its interests. In February 2012, the WDNR sent a proposed permit and response to the EPA for a 45-day review, which allowed the parties to enter into a settlement agreement that has been entered by the court. On May 9, 2012, the Sierra Club filed another Petition requesting the EPA to again object to the proposed permit and response. The Sierra Club recently filed a request for a contested case proceeding regarding the permit, which WPS plans to oppose.

We are reviewing all of these matters, but we do not expect them to have a material impact on our financial statements.

Columbia Title V Air Permit

In October 2009, the EPA issued an order objecting to the permit renewal issued by the WDNR for the Columbia plant. The order determined that the WDNR did not adequately analyze whether a project in 2006 constituted a major modification that required a permit. The EPA's order directed the WDNR to resolve the objections within 90 days and terminate, modify, or revoke and reissue the permit accordingly.

In July 2010, WPS, along with its co-owners, received from the Sierra Club a copy of an NOI to file a civil lawsuit against the EPA. The Sierra Club alleges that the EPA should assert jurisdiction over the permit because the WDNR failed to respond to the EPA's objection within 90 days.

In September 2010, the WDNR issued a draft construction permit and a draft revised Title V permit in response to the EPA's order. In November 2010, the EPA notified the WDNR that the EPA does not believe the WDNR's proposal is responsive to the order. In January 2011, the WDNR issued a letter stating that upon review of the submitted public comments, the WDNR has determined not to issue the draft permits that were proposed to respond to the EPA's order. In February 2011, the Sierra Club filed for a declaratory action, claiming that the EPA had to assert jurisdiction over the permits. In May 2011, the WDNR issued a second draft Title V permit in response to the EPA's order.

In June 2012, WP&L received notice from the EPA of the EPA's proposal for WP&L to apply for a federally-issued Title V permit since the WDNR has not addressed the EPA's objections to the Title V permit issues for the Columbia plant. The notice gave WP&L 90 days to comment on the EPA's proposal, which was later extended by the EPA to December 15, 2012. If the EPA decides to require the submittal of an operation permit, it would be due within six months of the EPA's notice to WP&L. WP&L believes the previously issued Title V permit for the Columbia plant is still valid. We do not expect this matter to have a material impact on our financial statements.

Table of Contents

Mercury and Interstate Air Quality Rules

Mercury:

The State of Wisconsin's mercury rule, Chapter NR 446, requires a 40% reduction from the 2002 through 2004 baseline mercury emissions in Phase I, beginning January 1, 2010, through the end of 2014. In Phase II, which begins in 2015, electric generating units above 150 megawatts will be required to reduce mercury emissions by 90% from the 2002 through 2004 baseline. Reductions can be phased in and the 90% target delayed until 2021 if additional sulfur dioxide and nitrogen oxide reductions are implemented. By 2015, electric generating units above 25 megawatts but less than 150 megawatts must reduce their mercury emissions to a level defined by the Best Available Control Technology rule. As of September 30, 2012, WPS estimates capital costs of approximately \$2 million, which includes estimates for both wholly owned and jointly owned plants, to achieve the required Phase I and Phase II reductions. The capital costs are expected to be recovered in future rates.

In December 2011, the EPA issued the final Utility Mercury and Air Toxics rule that will regulate emissions of mercury and other hazardous air pollutants beginning in 2015. We are currently evaluating options for achieving the emission limits specified in this rule, but we do not anticipate the cost of compliance to be significant. We expect to recover future compliance costs in future rates.

Sulfur Dioxide and Nitrogen Oxide:

The EPA issued the Clean Air Interstate Rule (CAIR) in 2005 in order to reduce sulfur dioxide and nitrogen oxide emissions from utility boilers located in 29 states, including Wisconsin, Michigan, Pennsylvania, and New York. In July 2008, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) issued a decision vacating CAIR. In response to requests by numerous parties, including the EPA, the D.C. Circuit reinstated CAIR in December 2008, but directed the EPA to address the deficiencies noted in its previous ruling to vacate CAIR. In July 2011, the EPA issued a final CAIR replacement rule known as the Cross State Air Pollution Rule (CSAPR), which numerous parties, including WPS, challenged in the D.C. Circuit. The new rule was to become effective January 1, 2012; however, on December 30, 2011, the D.C. Circuit issued a decision that stayed the rule pending resolution of the challenges and directed the EPA to implement CAIR during the stay period. On August 21, 2012, the D.C. Circuit issued their ruling vacating and remanding CSAPR and simultaneously reinstating CAIR pending the issuance of a replacement rule by the EPA. On October 5, 2012, the EPA and several other parties filed petitions for rehearing of the D.C. Circuit's decision. Responses to those petitions are due November 16, 2012.

Under CAIR, units affected by the Best Available Retrofit Technology (BART) rule were considered in compliance with BART for sulfur dioxide and nitrogen oxide emissions if they were in compliance with CAIR. This determination was updated when CSAPR was issued (CSAPR satisfied BART) and the EPA has not revised it to reflect the reinstatement of CAIR. Although particulate emissions also contribute to visibility impairment, the WDNR's modeling has shown the impairment to be so insignificant that additional capital expenditures on controls are not warranted.

Due to the uncertainty surrounding this rulemaking, we are currently unable to predict whether this will cause WPS to purchase additional emission allowances, idle or abandon certain units, or change how certain units are operated. WPS expects to recover any future compliance costs in future rates. The potential impact on Integrys Energy Services is not expected to be material.

Manufactured Gas Plant Remediation

Our natural gas utilities, their predecessors, and certain former affiliates operated facilities in the past at multiple sites for the purpose of manufacturing and storing manufactured gas. In connection with these activities, waste materials were produced that may have resulted in soil and groundwater contamination at these sites. Under certain laws and regulations relating to the protection of the environment, our natural gas utilities are required to undertake remedial action with respect to some of these materials. They are coordinating the investigation and cleanup of the sites subject to EPA jurisdiction under what is called a multi-site program. This program involves prioritizing the work to be done at the sites, preparation and approval of documents common to all of the sites, and use of a consistent approach in selecting remedies.

Our natural gas utilities are responsible for the environmental remediation of 53 sites, of which 20 have been transferred to the EPA Superfund Alternative Sites Program. Under the EPA's program, the remedy decisions at these sites will be made using risk-based criteria typically used at Superfund sites. As of September 30, 2012, we estimated and accrued for \$593.3 million of future undiscounted investigation and cleanup costs for all sites. We may adjust these estimates in the future due to remedial technology, regulatory requirements, remedy determinations, and any claims of natural resource damages. As of September 30, 2012, cash expenditures for environmental remediation not yet recovered in rates were \$34.5 million. We recorded a regulatory asset of \$627.8 million at September 30, 2012, which is net of insurance recoveries received of \$60.0 million, related to the expected recovery of both cash expenditures and estimated future expenditures through rates.

Management believes that any costs incurred for environmental activities relating to former manufactured gas plant operations that are not recoverable through contributions from other entities or from insurance carriers have been prudently incurred and are, therefore, recoverable through rates for WPS, MGU, PGL, and NSG. Accordingly, we do not expect these costs to have a material impact on our financial statements. However, any changes in the approved rate mechanisms for recovery of these costs, or any adverse conclusions by the various regulatory commissions with respect to the prudence of costs actually incurred, could materially affect rate recovery of such costs.

Table of Contents**NOTE 13 GUARANTEES**

The following table shows our outstanding guarantees:

(Millions)	Total Amounts Committed at September 30, 2012	Less Than 1 Year	Expiration 1 to 3 Years	Over 3 Years
Guarantees supporting commodity transactions of subsidiaries (1)	\$ 654.6	\$ 408.8	\$ 28.8	\$ 217.0
Standby letters of credit (2)	57.4	27.6	29.7	0.1
Surety bonds (3)	15.9	15.9		
Other guarantees (4)	42.9	20.0		22.9
Total guarantees	\$ 770.8	\$ 472.3	\$ 58.5	\$ 240.0

(1) Consists of parental guarantees of \$494.5 million to support the business operations of Integrys Energy Services; \$107.3 million and \$45.8 million, respectively, related to natural gas supply at MERC and MGU; and \$5.0 million at IBS, and \$2.0 million at UPPCO to support business operations. These guarantees are not reflected on our balance sheets.

(2) At our request or the request of our subsidiaries, financial institutions have issued standby letters of credit for the benefit of third parties that have extended credit to our subsidiaries. This amount consists of \$55.1 million issued to support Integrys Energy Services operations and \$2.3 million issued to support MERC, MGU, NSG, PGL, Pinnacle CNG Systems, UPPCO, and WPS. These amounts are not reflected on our balance sheets. The Integrys Energy Services amount includes a \$27.3 million letter of credit that was canceled as a result of the repayment of the WPS Westwood Generation, LLC loan in November 2012. See Note 10, Long-term Debt, for more information regarding this repayment.

(3) Primarily for workers compensation self-insurance programs and obtaining various licenses, permits, and rights-of-way. These guarantees are not reflected on our balance sheets.

(4) Consists of (a) \$20.0 million related to the sale agreement for Integrys Energy Services United States wholesale electric marketing and trading business, which included a number of customary representations, warranties, and indemnification provisions. This amount is not reflected on our balance sheets; (b) \$10.0 million related to the sale agreement for Integrys Energy Services Texas retail marketing business, which included a number of customary representations, warranties, and indemnification provisions. An insignificant liability was recorded related to the possible imposition of additional miscellaneous gross receipts tax in the event of a change in law or interpretation of the tax law; (c) \$5.0 million related to an environmental indemnification provided by Integrys Energy Services as part of the sale of the Stoneman generation facility, under which we expect that the likelihood of required performance is remote. This amount is not reflected on our balance sheets; and (d) \$7.9 million related to other indemnifications primarily for workers compensation coverage. These amounts are not reflected on our balance sheets.

We have provided total parental guarantees of \$588.3 million on behalf of Integrys Energy Services as shown in the table below. Our exposure under these guarantees related to existing transactions at September 30, 2012, was approximately \$212.5 million.

(Millions)	September 30,	
	2012	
Guarantees supporting commodity transactions	\$	494.5
Standby letters of credit		55.1
Surety bonds		3.2
Other		35.5
Total guarantees	\$	588.3

Table of Contents**NOTE 14 EMPLOYEE BENEFIT PLANS**

As of February 16, 2012, our defined benefit pension plans were closed to all new hires.

The following table shows the components of net periodic benefit cost (including amounts capitalized to our balance sheet) for our benefit plans:

(Millions)	Pension Benefits				Other Postretirement Benefits			
	Three Months		Nine Months		Three Months		Nine Months	
	Ended September 30	Ended September 30	Ended September 30	Ended September 30	Ended September 30	Ended September 30	Ended September 30	Ended September 30
	2012	2011	2012	2011	2012	2011	2012	2011
Service cost	\$ 11.5	\$ 10.3	\$ 34.5	\$ 31.0	\$ 5.2	\$ 4.8	\$ 15.6	\$ 14.3
Interest cost	19.5	20.0	58.5	60.1	7.1	7.3	21.4	22.1
Expected return on plan assets	(27.0)	(25.0)	(80.9)	(75.0)	(7.1)	(5.4)	(21.2)	(16.1)
Amortization of transition obligation					0.1	0.1	0.2	0.2
Amortization of prior service cost (credit)	1.3	1.4	3.8	4.0	(0.9)	(0.9)	(2.6)	(2.9)
Amortization of net actuarial loss	8.5	4.6	25.5	13.6	1.7	1.0	5.0	3.0
Net periodic benefit cost	\$ 13.8	\$ 11.3	\$ 41.4	\$ 33.7	\$ 6.1	\$ 6.9	\$ 18.4	\$ 20.6

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

We make contributions to our plans in accordance with legal and tax requirements. These contributions do not necessarily occur evenly throughout the year. We contributed \$173.0 million to our pension plans and \$75.1 million to our other postretirement benefit plans during the nine months ended September 30, 2012. Included in these contributions was an insignificant contribution related to WPS Westwood Generation, LLC, which is reflected in discontinued operations on the Statement of Cash Flows due to its pending sale. See Note 5, *Discontinued Operations*, for more information. We expect to contribute an additional \$3.0 million to our pension plans and \$39.1 million to our other postretirement benefit plans during the remainder of 2012, dependent upon various factors affecting us, including our liquidity position and tax law changes.

NOTE 15 STOCK-BASED COMPENSATION

The following table reflects the stock-based compensation expense and the related deferred tax benefit recognized in income for the three and nine months ended September 30:

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

(Millions)	Three Months Ended September 30			Nine Months Ended September 30		
	2012	2011	2011	2012	2011	2011
Stock options	\$ 0.5	\$ 0.4	\$ 1.5	\$ 1.4		
Performance stock rights	0.5		4.8	1.2		
Restricted shares and restricted share units	2.1	2.0	7.5	7.3		
Total stock-based compensation expense	\$ 3.1	\$ 2.4	\$ 13.8	\$ 9.9		
Deferred income tax benefit	\$ 1.2	\$ 1.0	\$ 5.5	\$ 4.0		

No stock-based compensation cost was capitalized during the three and nine months ended September 30, 2012, and 2011.

Stock Options

The fair value of stock option awards granted is estimated using a binomial lattice model. The expected term of option awards is calculated based on historical exercise behavior and represents the period of time that options are expected to be outstanding. The risk-free interest rate is based on the United States Treasury yield curve. The expected dividend yield incorporates the current and historical dividend rate. Our expected stock price volatility is estimated using its 10-year historical volatility. The following table shows the weighted-average fair value per stock option granted during the nine months ended September 30, 2012, along with the assumptions incorporated into the valuation model:

	February 2012 Grant
Weighted-average fair value per option	\$6.30
Expected term	5 years
Risk-free interest rate	0.17% - 2.18%
Expected dividend yield	5.28%
Expected volatility	25%

Table of Contents

A summary of stock option activity for the nine months ended September 30, 2012, and information related to outstanding and exercisable stock options at September 30, 2012, is presented below:

	Stock Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value (Millions)
Outstanding at December 31, 2011	2,953,630	\$ 48.09		
Granted	279,535	53.24		
Exercised	(1,159,757)	47.30		
Forfeited	(2,417)	53.24		
Outstanding at September 30, 2012	2,070,991	\$ 49.23	6.06	\$ 8.4
Exercisable at September 30, 2012	1,267,935	\$ 50.35	4.76	\$ 4.3

The aggregate intrinsic value for outstanding and exercisable options in the above table represents the total pre-tax intrinsic value that would have been received by the option holders had they all exercised their options at September 30, 2012. This is calculated as the difference between our closing stock price on September 30, 2012, and the option exercise price, multiplied by the number of in-the-money stock options. The intrinsic value of options exercised during the nine months ended September 30, 2012, and 2011, was \$10.8 million and \$1.1 million, respectively. The actual tax benefit realized for the tax deductions from these option exercises was \$4.4 million for the nine months ended September 30, 2012 and was not significant for the nine months ended September 30, 2011.

As of September 30, 2012, \$1.5 million of compensation cost related to unvested and outstanding stock options was expected to be recognized over a weighted-average period of 2.0 years.

Performance Stock Rights

The fair values of performance stock rights were estimated using a Monte Carlo valuation model. The risk-free interest rate is based on the United States Treasury yield curve. The expected dividend yield incorporates the current and historical dividend rate. The expected volatility was estimated using one to three years of historical data. The table below reflects the assumptions used in the valuation of the outstanding grants at September 30:

	2012
Risk-free interest rate	0.32% - 1.27%
Expected dividend yield	5.28% - 5.34%
Expected volatility	21% - 36%

A summary of the activity for the nine months ended September 30, 2012, related to performance stock rights accounted for as equity awards is presented below:

	Performance Stock Rights	Weighted-Average Fair Value(2)
Outstanding at December 31, 2011	135,948	\$ 46.18
Granted	18,865	52.70
Award modifications (1)	49,304	79.62
Distributed	(70,598)	42.93
Adjustment for final payout	(24,804)	42.93
Forfeited	(163)	52.70
Outstanding at September 30, 2012	108,552	65.35

(1) Six months prior to the end of the performance period, employees can no longer change their election to defer the value of their performance stock rights into the deferred compensation plan. As a result, any awards not elected for deferral at this point in the performance period will be settled in our common stock. This changes the classification of these awards from a liability award to an equity award. The change in classification is accounted for as an award modification.

(2) Reflects the weighted-average fair value used to measure equity awards. Equity awards are measured using the grant date fair value or the fair value on the modification date.

The weighted-average grant date fair value of performance stock rights awarded during the nine months ended September 30, 2012, and 2011, was \$52.70 and \$49.21, per performance stock right, respectively.

Table of Contents

A summary of the activity for the nine months ended September 30, 2012, related to performance stock rights accounted for as liability awards is presented below:

	Performance Stock Rights
Outstanding at December 31, 2011	186,215
Granted	75,408
Award modifications*	(49,304)
Distributed	(16,001)
Adjustment for final payout	(5,622)
Forfeited	(652)
Outstanding at September 30, 2012	190,044

* Six months prior to the end of the performance period, employees can no longer change their election to defer the value of their performance stock rights into the deferred compensation plan. As a result, any awards not elected for deferral at this point in the performance period will be settled in our common stock. This changes the classification of these awards from a liability award to an equity award. The change in classification is accounted for as an award modification.

The weighted-average fair value of all outstanding performance stock rights accounted for as liability awards as of September 30, 2012, was \$54.53 per performance stock right.

As of September 30, 2012, \$2.9 million of compensation cost related to unvested and outstanding performance stock rights (equity and liability awards) was expected to be recognized over a weighted-average period of 1.3 years.

The total intrinsic value of performance stock rights distributed during the nine months ended September 30, 2012, and 2011, was \$4.7 million and \$6.3 million, respectively. The actual tax benefit realized for the tax deductions from the distribution of performance stock rights during the nine months ended September 30, 2012, and 2011, was \$1.9 million and \$2.5 million, respectively.

Restricted Shares and Restricted Share Units

During the second quarter of 2011, the last of the outstanding restricted shares vested. Only restricted share units remain outstanding at September 30, 2012.

A summary of the activity related to all restricted share unit awards (equity and liability awards) for the nine months ended September 30, 2012, is presented below:

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

	Restricted Share Unit Awards	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2011	497,722	\$ 45.21
Granted	188,346	53.24
Dividend equivalents	19,209	48.22
Vested and released	(196,491)	45.12
Forfeited	(3,095)	49.10
Outstanding at September 30, 2012	505,691	48.38

As of September 30, 2012, \$12.0 million of compensation cost related to these awards was expected to be recognized over a weighted-average period of 2.4 years.

The total intrinsic value of restricted share and restricted share unit awards vested and released during the nine months ended September 30, 2012, and 2011, was \$10.5 million and \$6.6 million, respectively. The actual tax benefit realized for the tax deductions from the vesting and release of restricted shares and restricted share units during the nine months ended September 30, 2012, and 2011, was \$4.2 million and \$2.6 million, respectively.

The weighted-average grant date fair value of restricted share units awarded during the nine months ended September 30, 2012, and 2011, was \$53.24 and \$49.39 per share, respectively.

Table of Contents**NOTE 16 COMMON EQUITY**

We had no changes to issued common stock during the nine months ended September 30, 2012.

Beginning May 1, 2011, 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.

The following table reconciles common shares issued and outstanding:

	September 30, 2012		December 31, 2011	
	Shares	Average Cost	Shares	Average Cost
Common stock issued	78,287,906		78,287,906	
Less:				
Deferred compensation rabbi trust	380,636	\$ 45.94*	382,971	\$ 44.54*
Total common shares outstanding	77,907,270		77,904,935	

* Based on our stock price on the day the shares entered the deferred compensation rabbi trust. Shares paid out of the trust are valued at the average cost of shares in the trust.

Earnings Per Share

Basic earnings per share is computed by dividing net income attributed to common shareholders by the weighted average number of common shares outstanding during the period, adjusted for shares we are obligated to issue under the deferred compensation and restricted share unit plans. Diluted earnings per share is computed in a similar manner, but includes the exercise and/or conversion of all potentially dilutive securities. Such dilutive items include in-the-money stock options, performance stock rights, restricted share units, and certain shares issuable under the deferred compensation plan. The calculations of diluted earnings per share for the three months ended September 30, 2012, and 2011, excluded 0.9 million and 0.8 million, respectively, out-of-the-money stock options that had an anti-dilutive effect. The calculations of diluted earnings per share for the nine months ended September 30, 2012, and 2011, excluded 0.6 million and 0.8 million, respectively, out-of-the-money stock options that had an anti-dilutive effect. The following table reconciles our computation of basic and diluted earnings per share:

(Millions, except per share amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
<u>Numerator:</u>				
Net income from continuing operations	\$ 74.2	\$ 37.4	\$ 224.3	\$ 193.9
Discontinued operations, net of tax	(7.9)	0.2	(8.7)	(2.9)

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Preferred stock dividends of subsidiary	(0.7)	(0.7)	(2.3)	(2.3)
Noncontrolling interest in subsidiaries	0.1		0.1	
Net income attributed to common shareholders	\$ 65.7	\$ 36.9	\$ 213.4	\$ 188.7
Denominator:				
Average shares of common stock basic	78.5	78.7	78.5	78.6
Effect of dilutive securities				
Stock-based compensation	0.6	0.5	0.6	0.3
Deferred compensation	0.2		0.2	
Average shares of common stock diluted	79.3	79.2	79.3	78.9
Earnings per common share				
Basic	\$ 0.84	\$ 0.47	\$ 2.72	\$ 2.40
Diluted	0.83	0.47	2.69	2.39

Table of Contents**Accumulated Other Comprehensive Loss**

The following table shows the changes to our accumulated other comprehensive loss from December 31, 2011 to September 30, 2012:

	Cash Flow Hedges	Defined Benefit Pension Plans	Accumulated Other Comprehensive Income (Loss)
Beginning balance at December 31, 2011	\$ (11.5)	\$ (31.0)	\$ (42.5)
Current period other comprehensive income	4.0	1.1	5.1
Ending balance at September 30, 2012	\$ (7.5)	\$ (29.9)	\$ (37.4)

Dividend Restrictions

Our ability as a holding company to pay dividends is largely dependent upon the availability of funds from our subsidiaries. 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, with the exception of MGU, are prohibited from loaning funds to us, either directly or indirectly.

The PSCW allows WPS to pay dividends on its common stock of no more than 103% of the previous year's common stock dividend. WPS may return capital to us if its average financial common equity ratio is at least 50.24% on a calendar-year basis. WPS must obtain PSCW approval if a return of capital would cause its average financial common equity ratio to fall below this level. Our right to receive dividends on the common stock of WPS is also subject to the prior rights of WPS's preferred shareholders and to provisions in WPS's restated articles of incorporation, which limit the amount of common stock dividends that WPS may pay if its common stock and common stock surplus accounts constitute less than 25% of its total capitalization.

NSG's long-term debt obligations contain provisions and covenants restricting the payment of cash dividends and the purchase or redemption of its capital stock.

PGL and WPS have short-term debt obligations containing 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 their outstanding debt obligations.

We also have short-term and long-term debt obligations that 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. At September 30, 2012, these covenants did not restrict the payment of any dividends beyond the amount restricted under our subsidiary requirements described above.

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

As of September 30, 2012, total restricted net assets were \$1,480.4 million. Our equity in undistributed earnings of 50% or less owned investees accounted for by the equity method was \$121.0 million at September 30, 2012.

We also have the option to defer interest payments on our outstanding Junior Subordinated Notes, from time to time, for one or more periods of up to ten consecutive years per period. During any period in which we defer interest payments, we may not declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment on, any of our capital stock.

Except for the restrictions described above and subject to applicable law, we do not have any other significant dividend restrictions.

Table of Contents**Capital Transactions with Subsidiaries**

During the nine months ended September 30, 2012, capital transactions with subsidiaries were as follows (in millions):

Subsidiary	Dividends To Parent	Return Of Capital To Parent	Equity Contributions From Parent
WPS	\$ 79.1	\$ 50.0	\$ 40.0
WPS Investments, LLC (1)	50.8		17.0
PGL (2)	55.0		
NSG (2)	10.0		
MERC		18.0	11.0
IBS		23.0	10.0
MGU		6.0	
UPPCO		11.5	8.5
Total	\$ 194.9	\$ 108.5	\$ 86.5

(1) WPS Investments, LLC is a consolidated subsidiary that is jointly owned by us, WPS, and UPPCO. At September 30, 2012, we had an 85.70% ownership interest, while WPS and UPPCO had an 11.79% and 2.51% ownership interest, respectively. Distributions from WPS Investments, LLC are made to the owners based on their respective ownership percentages. During 2012, all equity contributions to WPS Investments, LLC were made solely by us.

(2) PGL and NSG are direct wholly owned subsidiaries of PELLC. As a result, they make distributions to PELLC, and receive equity contributions from PELLC. Subject to applicable law, PELLC does not have any dividend restrictions or limitations on distributions to us.

NOTE 17 VARIABLE INTEREST ENTITIES

In 2012, ITF formed AMP Trillium LLC as a joint venture with AMP Americas LLC. ITF owns 30% and AMP Americas LLC owns 70% of the joint venture. The joint venture was established to own and operate compressed natural gas fueling stations. The preferred source of capital funding for the joint venture will be loans from ITF. We determined that the joint venture is a variable interest entity and that ITF is the primary beneficiary, which requires us to consolidate the assets, liabilities, and statements of income of the joint venture. At September 30, 2012, our variable interests in the joint venture included an insignificant equity investment and insignificant receivables. Our maximum exposure to loss as a result of this joint venture was not significant. The carrying amounts of AMP Trillium LLC assets and liabilities included on our September 30, 2012, balance sheet were also not significant.

In 2011, ITF formed Integrys PTI CNG Fuels LLC as a joint venture with Paper Transport Inc. ITF and Paper Transport Inc. each own 50% of the joint venture. The joint venture was established to own and operate compressed natural gas fueling stations. The preferred source of capital funding for the joint venture will be loans from ITF. We determined that the joint venture is a variable interest entity and that ITF is the primary beneficiary, which requires us to consolidate the assets, liabilities, and statements of income of the joint venture. At September 30, 2012, and December 31, 2011, our variable interests in the joint venture included an insignificant equity investment and insignificant receivables. Our maximum exposure to loss as a result of this joint venture was not significant. The carrying amounts of Integrys PTI CNG Fuels LLC assets and

liabilities included on our balance sheets were not significant.

We have variable interests in two entities through power purchase agreements relating to the cost of fuel. One of these agreements reimburses an independent power producing entity for coal costs relating to purchased energy. There is no obligation to purchase energy under the agreement. This contract for 17.5 megawatts of capacity expires in 2014. The other agreement contains a 500-megawatt tolling arrangement in which we supply the scheduled fuel and purchase capacity and energy from the facility. In connection with the pending purchase of Fox Energy Company LLC, WPS will pay \$50.0 million to terminate this tolling arrangement. See Note 4, *Agreement to Purchase Fox Energy Center*, for more information regarding this pending purchase. As of September 30, 2012, and December 31, 2011, we had a total of 517.5 megawatts of capacity available under these agreements. We evaluated both of these variable interest entities for possible consolidation. We considered which interest holder has the power to direct the activities that most significantly impact the economics of the variable interest entity; this interest holder is considered the primary beneficiary of the entity and is required to consolidate the entity. For a variety of reasons, including qualitative factors such as the length of the remaining term of the contracts compared with the remaining lives of the plants and the fact that we do not have the power to direct the operations and maintenance of the facilities, we determined we are not the primary beneficiary of these variable interest entities. At September 30, 2012, and December 31, 2011, the assets and liabilities on the balance sheets that related to our involvement with these variable interest entities pertained to working capital accounts and represented the amounts we owed for current deliveries of power. We have not guaranteed any debt or provided any equity support, liquidity arrangements, performance guarantees, or other commitments associated with these contracts. There is not a significant potential exposure to loss as a result of involvement with the variable interest entities.

Table of Contents**NOTE 18 FAIR VALUE****Fair Value Measurements**

The following tables show assets and liabilities that were accounted for at fair value on a recurring basis, categorized by level within the fair value hierarchy:

(Millions)	September 30, 2012			Total
	Level 1	Level 2	Level 3	
Risk Management Assets				
Utility Segments				
Natural gas contracts	\$ 4.5	\$ 6.6	\$	\$ 11.1
Financial transmission rights (FTRs)			3.4	3.4
Petroleum product contracts	0.3			0.3
Nonregulated Segments				
Natural gas contracts	23.5	58.7	4.1	86.3
Electric contracts	37.8	57.1	5.0	99.9
Foreign exchange contracts		0.1		0.1
Total Risk Management Assets	\$ 66.1	\$ 122.5	\$ 12.5	\$ 201.1
Risk Management Liabilities				
Utility Segments				
Natural gas contracts	\$ 0.2	\$ 18.7	\$	\$ 18.9
FTRs			0.2	0.2
Coal contract			9.3	9.3
Nonregulated Segments				
Natural gas contracts	35.7	41.2	1.7	78.6
Electric contracts	47.4	85.4	14.3	147.1
Foreign exchange contracts	0.1			0.1
Total Risk Management Liabilities	\$ 83.4	\$ 145.3	\$ 25.5	\$ 254.2

(Millions)	December 31, 2011			Total
	Level 1	Level 2	Level 3	
Risk Management Assets				
Utility Segments				
Natural gas contracts	\$ 0.1	\$ 9.1	\$	\$ 9.2
FTRs			2.3	2.3
Petroleum product contracts	0.1			0.1
Nonregulated Segments				
Natural gas contracts	50.7	104.1	8.7	163.5
Electric contracts	41.2	71.2	3.9	116.3
Foreign exchange contracts		0.2		0.2
Total Risk Management Assets	\$ 92.1	\$ 184.6	\$ 14.9	\$ 291.6
Risk Management Liabilities				
Utility Segments				
Natural gas contracts	\$ 5.5	\$ 39.2	\$	\$ 44.7
FTRs			0.1	0.1

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Coal contract			6.9		6.9
Nonregulated Segments					
Natural gas contracts	55.0	105.6	0.4		161.0
Electric contracts	54.2	131.1	15.4		200.7
Foreign exchange contracts	0.2				0.2
Total Risk Management Liabilities	\$ 114.9	\$ 275.9	\$ 22.8	\$	413.6

The risk management assets and liabilities listed in the tables above include options, swaps, futures, physical commodity contracts, and other instruments used to manage market risks related to changes in commodity prices. See Note 3, *Risk Management Activities*, for more information on derivative instruments.

The tables above include amounts that were classified as held for sale at Integrys Energy Services. The carrying value of our assets and liabilities from risk management activities that were classified as held for sale is shown in the table below. See Note 5, *Discontinued Operations*, for more information.

Table of Contents

(Millions)	September 30, 2012	December 31, 2011
Risk Management Assets		
Nonregulated Segments		
Electric contracts Level 2	\$ 0.1	\$
Risk Management Liabilities		
Nonregulated Segments		
Electric contracts Level 2	0.1	0.1

The following tables show net risk management assets (liabilities) transferred between the levels of the fair value hierarchy:

Nonregulated Segments - Electric Contracts

(Millions)	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Transfers into Level 1 from	N/A	\$	\$	N/A	\$	\$
Transfers into Level 2 from	\$	N/A	(1.9)	\$	N/A	0.7
Transfers into Level 3 from		1.0	N/A		(1.5)	N/A

Nonregulated Segments - Electric Contracts

(Millions)	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Transfers into Level 1 from	N/A	\$	\$	N/A	\$	(1.6)
Transfers into Level 2 from	\$	N/A	(5.8)	\$	N/A	(6.1)
Transfers into Level 3 from		(7.8)	N/A		(6.8)	N/A

Nonregulated Segments - Natural Gas Contracts

(Millions)	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Transfers into Level 1 from	N/A	\$	\$	N/A	\$	\$
Transfers into Level 2 from	\$	N/A	0.3	\$	N/A	0.1
Transfers into Level 3 from		0.4	N/A		0.2	N/A

Nonregulated Segments - Natural Gas Contracts

(Millions)	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Transfers into Level 1 from	N/A	\$	\$	N/A	\$	\$

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Transfers into Level 2 from	\$	N/A	1.7	\$	N/A	0.7
Transfers into Level 3 from		3.2	N/A		0.2	N/A

Derivatives are transferred between the levels of the fair value hierarchy primarily due to changes in the source of data used to construct price curves as a result of changes in market liquidity. We recognize transfers between the levels of the fair value hierarchy at the value as of the end of the reporting period.

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

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Table of Contents

We conduct a thorough review of fair value hierarchy classifications on a quarterly basis.

We have established risk oversight committees whose primary responsibility includes directly or indirectly ensuring that all valuation methods are applied in accordance with predefined policies. The development and maintenance of our forward price curves has been assigned to our risk management department, which is part of the corporate treasury function. This group is separate and distinct from any of the trading functions within the organization. To validate the reasonableness of our fair value inputs, our risk management department compares changes in valuation and researches any significant differences in order to determine the underlying cause. Corrections to the fair value inputs are made if necessary.

The significant unobservable inputs used in the valuation that resulted in categorization within Level 3 were as follows at September 30, 2012. The amounts and percentages listed in the table below represent the range of unobservable inputs that individually had a significant impact on the fair value determination and caused a derivative transaction to be classified as Level 3.

	Fair Value (Millions)		Valuation Technique	Unobservable Input	Average or Range	
	Assets	Liabilities				
Utility Segments						
FTRs				Forward market prices		
	\$ 3.4	\$ 0.2	Market-based	(\$/megawatt-month) (1)	175.25	
Coal contract		9.3	Market-based	Forward market prices (\$/ton) (2)	14.75	16.20
Nonregulated Segments						
Natural gas contracts	86.3	78.6	Market-based	Forward market prices (\$/dekatherm) (3)	(0.03)	2.17
				Probability of default	11.62%	50.99%
Electric contracts	99.9	147.1	Market-based	Forward market prices (\$/megawatt-hours) (3)	(4.40)	46.98
				Option volatilities (4)	21.20%	54.47%
				Monthly curve shaping (5)	(61.70)%	29.63%

- (1) Represents forward market prices developed using historical cleared pricing data from MISO used in the valuation of FTRs.
- (2) Represents third-party forward market pricing used in the valuation of our coal contract.
- (3) Represents unobservable basis spreads developed using historical settled prices that are applied to observable market prices at various natural gas and electric locations, as well as unobservable adjustments made to extend observable market prices beyond the quoted period through the end of the transaction term.
- (4) Represents the range of volatilities used in the valuation of options.
- (5) Represents adjustments made to forward market price curves to disaggregate average prices of multiple periods into discrete monthly prices.

Significant changes in historical settlement prices, forward commodity prices, and option volatilities would result in a directionally similar significant change in fair value. Significant changes in probability of default would result in a significant directionally opposite change in fair value. Changes in the adjustments to prices related to monthly curve shaping would affect fair value differently depending on their direction.

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

Edgar Filing: INTEGRYS ENERGY GROUP, INC. - Form 10-Q

Three Months Ended September 30, 2012 (Millions)	Nonregulated Segments		Utility Segments		Total
	Natural Gas	Electric	FTRs	Coal Contract	
Balance at the beginning of the period	\$ 6.3	\$ (14.7)	\$ 4.8	\$ (9.8)	\$ (13.4)
Net realized and unrealized gains (losses) included in earnings	2.7	2.6*	(1.0)		4.3
Net unrealized (losses) gains recorded as regulatory assets or liabilities			(0.2)	2.1	1.9
Settlements	(6.7)	(0.1)	(0.4)	(1.6)	(8.8)
Net transfers into Level 3	0.4	1.0			1.4
Net transfers out of Level 3	(0.3)	1.9			1.6
Balance at the end of the period	\$ 2.4	\$ (9.3)	\$ 3.2	\$ (9.3)	\$ (13.0)
Net unrealized gains included in earnings related to instruments still held at the end of the period	\$ 2.7	\$ 2.6*	\$	\$	\$ 5.3

* Includes a \$0.2 million net unrealized loss reported as discontinued operations. See Note 5, *Discontinued Operations*, for more information.

Table of Contents

Nine Months Ended September 30, 2012 (Millions)	Nonregulated Segments		Utility Segments		Total
	Natural Gas	Electric	FTRs	Coal Contract	
Balance at the beginning of the period	\$ 8.3	\$ (11.5)	\$ 2.2	\$ (6.9)	\$ (7.9)
Net realized and unrealized gains (losses) included in earnings	1.9	(5.3)*	1.5		(1.9)
Net unrealized gains recorded as regulatory assets or liabilities			0.1	1.5	1.6
Purchases		2.1	4.9		7.0
Sales			(0.1)		(0.1)
Settlements	(9.3)	7.4	(5.4)	(3.9)	(11.2)
Net transfers into Level 3	3.2	(7.8)			(4.6)
Net transfers out of Level 3	(1.7)	5.8			4.1
Balance at the end of the period	\$ 2.4				