

WISCONSIN ENERGY CORP  
Form 10-K  
February 26, 2010

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

FORM 10-K

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

For the Fiscal Year Ended

**December 31, 2009**

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| <u>Commission<br/>File Number</u> | <u>Registrant; State of Incorporation<br/>Address; and Telephone Number</u>   | <u>IRS Employer<br/>Identification No.</u> |
|-----------------------------------|---|--|
| 001-09057                         | WISCONSIN ENERGY CORPORATION<br>(A Wisconsin Corporation)<br>231 West Michigan Street<br>P.O. Box 1331<br>Milwaukee, WI 53201<br>(414) 221-2345 | 39-1391525                                 |

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Securities Registered Pursuant to Section 12(b) of the Act:

| <u>Title of Each Class</u>    | <u>Name of Each Exchange<br/>on Which Registered</u> |
|-------------------------------|--|
| Common Stock, \$.01 Par Value | New York Stock Exchange                              |

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this Chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not Smaller reporting company   
check if a 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

The aggregate market value of the common stock of Wisconsin Energy Corporation held by non-affiliates was approximately \$4.8 billion based upon the reported closing price of such securities as of June 30, 2009.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date (January 31, 2010):

Common Stock, \$.01 Par Value, 116,900,785 shares outstanding

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Documents Incorporated by Reference

Portions of Wisconsin Energy Corporation's definitive Proxy Statement on Schedule 14A for its Annual Meeting of Stockholders, to be held on May 6, 2010, are incorporated by reference into Part III hereof.

WISCONSIN ENERGY CORPORATION  
FORM 10-K REPORT FOR THE YEAR ENDED DECEMBER 31, 2009

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### DEFINITION OF ABBREVIATIONS AND INDUSTRY TERMS

The abbreviations and terms set forth below are used throughout this report and have the meanings assigned to them below:

#### Wisconsin Energy Subsidiaries and Affiliates

##### Primary Subsidiary and Affiliates

Edison Sault

Edison Sault Electric Company

We Power

W.E. Power, LLC

Wisconsin Electric

Wisconsin Electric Power Company

Wisconsin Gas

Wisconsin Gas LLC

##### Significant Assets

OC 1

Oak Creek expansion Unit 1

OC 2

Oak Creek expansion Unit 2

PWGS

Port Washington Generating Station

PWGS 1

Port Washington Generating Station Unit 1

PWGS 2

Port Washington Generating Station Unit 2

Other Affiliates

ATC

American Transmission Company LLC

ERGSS

Elm Road Generating Station Supercritical, LLC

ERS

Elm Road Services, LLC

Minergy

Minergy LLC

WICOR

Wicor, Inc.

Wispark

Wispark LLC

Wisvest

Wisvest LLC

Federal and State Regulatory Agencies

DOA

Wisconsin Department of Administration

DOE

United States Department of Energy

EPA

United States Environmental Protection Agency

FERC

Federal Energy Regulatory Commission

IRS

Internal Revenue Service

MDEQ

Michigan Department of Environmental Quality

MPSC

Michigan Public Service Commission

NRC

United States Nuclear Regulatory Commission

PSCW

Public Service Commission of Wisconsin

SEC

Securities and Exchange Commission

WDNR

Wisconsin Department of Natural Resources

Environmental Terms

Act 141

2005 Wisconsin Act 141

BART

Best Available Retrofit Technology

BTA

Best Technology Available

CAA

Clean Air Act

CAIR

Clean Air Interstate Rule

CAMR

Clean Air Mercury Rule

CAVR

Clean Air Visibility Rule

CERCLA

Comprehensive Environmental Response, Compensation and Liability Act

CO<sub>2</sub>

Carbon Dioxide

CWA

Clean Water Act

MACT

Maximum Achievable Control Technology

NOV

Notice of Violation

NO<sub>x</sub>

Nitrogen Oxide

PM<sub>2.5</sub>

Fine Particulate Matter

#### DEFINITION OF ABBREVIATIONS AND INDUSTRY TERMS

The abbreviations and terms set forth below are used throughout this report and have the meanings assigned to them below:



|                 |  |
|-----------------|--|
| RACT            | Reasonably Available Control Technology          |
| SIP             | State Implementation Plan                        |
| SO <sub>2</sub> | Sulfur Dioxide                                   |
| WPDES           | Wisconsin Pollution Discharge Elimination System |

Other Terms and Abbreviations

ALJ

Wisconsin Administrative Law Judge

ANPR

Advanced Notice of Proposed Rulemaking

AQCS

Air Quality Control System

ARRs

Auction Revenue Rights

Bechtel

Bechtel Power Corporation

Compensation Committee

Compensation Committee of the Board of Directors of Wisconsin Energy

CPCN

Certificate of Public Convenience and Necessity

Energy Policy Act

Energy Policy Act of 2005

ERISA

Employee Retirement Income Security Act of 1974

Fitch

Fitch Ratings

FPL

FPL Group, Inc.

FTRs

Financial Transmission Rights

GCRM

Gas Cost Recovery Mechanism

GDP

Gross Domestic Product

Guardian

Guardian Pipeline L.L.C.

Junior Notes

Wisconsin Energy's 2007 Series A Junior Subordinated Notes due 2067 issued in May 2007

LLC

Limited Liability Company

LMP

Locational Marginal Price

LSEs

Load Serving Entities

MAIN

Mid-America Interconnected Network, Inc.

MISO

Midwest Independent Transmission System Operator, Inc.

MISO Energy Markets

MISO Energy and Operating Reserves Market

Moody's

Moody's Investor Service

NMC

Nuclear Management Company, LLC

NYMEX

New York Mercantile Exchange

OTC

Over-the-Counter

PJM

PJM Interconnection, L.L.C.

Plan

The Wisconsin Energy Corporation Retirement Account Plan

Point Beach

Point Beach Nuclear Power Plant

PRSG

Planning Reserve Sharing Groups

PSEG

Public Service Enterprise Group

PTF

Power the Future

PUHCA 2005

Public Utility Holding Company Act of 2005

RCC

Replacement Capital Covenant dated May 11, 2007

RFC

Reliability First Corporation

RSG

Revenue Sufficiency Guarantee

RTO

Regional Transmission Organizations

Settlement Agreement

Settlement Agreement and Release between ERS and Bechtel effective as of December 16, 2009

S&P

Standard & Poor's Ratings Services

WPL

Wisconsin Power and Light Company, a subsidiary of Alliant Energy Corp.

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#### DEFINITION OF ABBREVIATIONS AND INDUSTRY TERMS

The abbreviations and terms set forth below are used throughout this report and have the meanings assigned to them below:

##### Measurements

|      |  |
|------|--|
| Btu  | British thermal units(s)                       |
| Dth  | Dekatherm(s) (One Dth equals one million Btu)  |
| kW   | Kilowatt(s) (One kW equals one thousand watts) |
| kWh  | Kilowatt-hour(s)                               |
| MW   | Megawatt(s) (One MW equals one million watts)  |
| Watt | A measure of power production or usage         |

##### Accounting Terms

|       |  |
|-------|--|
| AFUDC | Allowance for Funds Used During Construction |
| ARO   | Asset Retirement Obligation                  |
| CWIP  | Construction Work in Progress                |
| FASB  | Financial Accounting Standards Board         |
| GAAP  | Generally Accepted Accounting Principles     |
| IFRS  | International Financial Reporting Standards  |

NOLs  
OPEB

Net Operating Loss Carryforwards  
Other Post-Retirement Employee Benefits

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### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements contained in this report are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based upon management's current expectations and are subject to risks and uncertainties that could cause our actual results to differ materially from those contemplated in the statements. Readers are cautioned not to place undue reliance on these forward-looking statements. Forward-looking statements include, among other things, statements concerning management's expectations and projections regarding earnings, completion of construction projects, regulatory matters, fuel costs, sources of electric energy supply, coal and gas deliveries, remediation costs, environmental and other capital expenditures, liquidity and capital resources and other matters. In some cases, forward-looking statements may be identified by reference to a future period or periods or by the use of forward-looking terminology such as "anticipates," "believes," "estimates," "expects," "forecasts," "guidance," "intends," "may," "objectives," "plans," "possible," "potential," "projects," "should" or similar terms or variations of these terms.

Actual results may differ materially from those set forth in forward-looking statements. In addition to the assumptions and other factors referred to specifically in connection with these statements, factors that could cause our actual results to differ materially from those contemplated in any forward-looking statements or otherwise affect our future results of operations and financial condition include, among others, the following:

- Factors affecting utility operations such as unusual weather conditions; catastrophic weather-related or terrorism-related damage; availability of electric generating facilities; unscheduled generation outages, or unplanned maintenance or repairs; unanticipated events causing scheduled generation outages to last longer than expected; unanticipated changes in fossil fuel, purchased power, coal supply, gas supply or water supply costs or availability due to higher demand, shortages, transportation problems or other developments; nonperformance by electric energy or natural gas suppliers under existing power purchase or gas supply contracts; environmental incidents; electric transmission or gas pipeline system constraints; unanticipated organizational structure or key personnel changes; collective bargaining agreements with union employees or work stoppages; or inflation rates.
- Factors affecting the economic climate in our service territories such as customer growth; customer business conditions, including demand for their products and services; and changes in market demand and demographic patterns.
- Timing, resolution and impact of pending and future rate cases and negotiations, including recovery for new investments as part of our PTF strategy, environmental compliance, transmission service, fuel costs and costs associated with the MISO Energy Markets.
- Regulatory factors such as changes in rate-setting policies or procedures; changes in regulatory accounting policies and practices; industry restructuring initiatives; transmission or distribution system operation and/or administration initiatives; required changes in facilities or operations to reduce the risks or impacts of potential terrorist activities; required approvals for new construction; and the siting approval process for new generation and transmission facilities and new pipeline construction.
- Increased competition in our electric and gas markets and continued industry consolidation.
- Factors which impede or delay execution of our PTF strategy, including the adverse interpretation or enforcement of permit conditions by the permitting agencies; construction delays; and obtaining the investment capital from outside sources necessary to implement the strategy.

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- The impact of recent and future federal, state and local legislative and regulatory changes, including electric and gas industry restructuring initiatives; changes to the Federal Power Act and related regulations under the Energy Policy Act and enforcement thereof by FERC and other regulatory agencies; changes in allocation of energy assistance, including state public benefits funds; changes in environmental, tax and other laws and regulations to which we are subject; and changes in the application of existing laws and regulations.
- Restrictions imposed by various financing arrangements and regulatory requirements on the ability of our subsidiaries to transfer funds to us in the form of cash dividends, loans or advances.
- The cost and other effects of legal and administrative proceedings, settlements, investigations, claims and changes in those matters.

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- Events in the global credit markets that may affect the availability and cost of capital.
- Other factors affecting our ability to access the capital markets, including general capital market conditions; our capitalization structure; market perceptions of the utility industry, us or any of our subsidiaries; and our credit ratings.
- The investment performance of our pension and other post-retirement benefit plans.
- The effect of accounting pronouncements issued periodically by standard setting bodies.
- Unanticipated technological developments that result in competitive disadvantages and create the potential for impairment of existing assets.
- Changes in the creditworthiness of the counterparties with whom we have contractual arrangements, including participants in the energy trading markets and fuel suppliers and transporters.
- The cyclical nature of property values that could affect our real estate investments.
- Changes to the legislative or regulatory restrictions or caps on non-utility acquisitions, investments or projects, including the State of Wisconsin's public utility holding company law.
- Other business or investment considerations that may be disclosed from time to time in our SEC filings or in other publicly disseminated written documents, including the risk factors set forth in Item 1A of this report.

We expressly disclaim any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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### PART I

#### ITEM 1. BUSINESS

#### INTRODUCTION

Wisconsin Energy Corporation was incorporated in the State of Wisconsin in 1981 and became a diversified holding company in 1986. We maintain our principal executive offices in Milwaukee, Wisconsin. Unless qualified by their context when used in this document, the terms Wisconsin Energy, the Company, our, us or we refer to the holding company and all of its subsidiaries.

We conduct our operations primarily in two operating segments: a utility energy segment and a non-utility energy segment. Our primary subsidiaries are Wisconsin Electric, Wisconsin Gas and We Power.

#### Utility Energy Segment:

Our utility energy segment consists of Wisconsin Electric and Wisconsin Gas, operating together under the trade name of We Energies, and Edison Sault. We Energies serves approximately 1,117,400 electric customers in Wisconsin and the Upper Peninsula of Michigan. We Energies serves approximately 1,060,200 gas customers in Wisconsin and approximately 465 steam customers in metropolitan Milwaukee, Wisconsin. Edison Sault serves approximately 23,000 electric customers in the Upper Peninsula of Michigan.

In October 2009, we announced that we reached an agreement to sell Edison Sault to Cloverland Electric Cooperative for approximately \$61.5 million. See Utility Energy Segment -- Electric Utility Operations - Electric Sales below for additional information on the planned sale of Edison Sault.

#### Non-Utility Energy Segment:

Our non-utility energy segment consists primarily of We Power. We Power was formed in 2001 to design, construct, own and lease the new generating capacity included in our PTF strategy. See below and in Item 7 for more information on PTF.

#### PTF Strategy:

In September 2000, we announced our PTF strategy to improve the supply and reliability of electricity in Wisconsin. As part of our PTF strategy, we are: (1) investing in new natural gas-fired and coal-fired electric generating facilities, (2) upgrading Wisconsin Electric's existing electric generating facilities and (3) investing in upgrades of our existing energy distribution system. Also, as part of this strategy, we announced and began implementing plans to divest non-core assets and operations in our non-utility energy segment and to reduce our real estate operations. Additional information concerning PTF may be found below under Non-Utility Energy Segment, as well as in Item 7.

For further financial information about our business segments, see Results of Operations in Item 7 and Note Q -- Segment Reporting in the Notes to Consolidated Financial Statements in Item 8.

Our annual and periodical filings with the SEC are available, free of charge, through our Internet website [www.wisconsinenergy.com](http://www.wisconsinenergy.com). These documents are available as soon as reasonably practicable after such materials are filed (or furnished) with the SEC.

## UTILITY ENERGY SEGMENT

### ELECTRIC UTILITY OPERATIONS

Our electric utility operations consist of the electric operations of Wisconsin Electric and Edison Sault. Wisconsin Electric, which is the largest electric utility in the State of Wisconsin, generates and distributes electric energy in a territory in southeastern (including the metropolitan Milwaukee area), east central and northern Wisconsin and in the Upper Peninsula of Michigan. Edison Sault generates and distributes electric energy in a territory in the eastern Upper Peninsula of Michigan.

Wisconsin Electric and Edison Sault participate in the MISO Energy Markets. The competitiveness of our generation offered in the MISO Energy Markets affects how our generating units are dispatched and how we buy and sell power. For further information, see Factors Affecting Results, Liquidity and Capital Resources in Item 7.

#### Electric Sales

Our electric energy sales to all classes of customers, excluding intercompany sales between Edison Sault and Wisconsin Electric, totaled approximately 29.2 million MWh during 2009 and approximately 31.9 million MWh during 2008. We had approximately 1,140,400 electric customers as of December 31, 2009 and 1,137,800 electric customers as of December 31, 2008.

#### Wisconsin Electric:

Wisconsin Electric is authorized to provide retail electric service in designated territories in the state of Wisconsin, as established by indeterminate permits, CPCNs or boundary agreements with other utilities, and in certain territories in the state of Michigan pursuant to franchises granted by municipalities. Wisconsin Electric also sells wholesale electric power within the MISO Energy Markets.

#### Edison Sault:

Edison Sault is authorized to provide retail electric service in certain territories in the state of Michigan pursuant to franchises granted by municipalities. Edison Sault also provides wholesale electric service under contract with one rural cooperative, Cloverland Electric Cooperative.

In October 2009, we entered into an agreement to sell Edison Sault to Cloverland Electric Cooperative for approximately \$61.5 million. We will retain the membership interest in ATC currently held by Edison Sault. The sale is contingent upon certain conditions, including the approval by regulatory bodies. If the conditions are satisfied, we expect the sale to be completed in 2010.

#### Electric Sales Growth:

Our service territory experienced a significant economic recession during late 2008 and into 2009. Our normalized 2009 electric sales, excluding our two largest customers, two iron ore mines, were approximately 5.6% lower than our normalized 2008 electric sales. As we look toward 2010 and beyond, we presently anticipate total retail and municipal electric kWh sales of our utility energy segment will grow at an annual rate of 0.5% to 1.0% over the next five years. This estimate assumes normal weather and excludes the two iron ore mines. We also anticipate that our peak electric demand will grow at an annual rate of 1.0% to 1.5% over the next five years.

#### Sales to Large Electric Retail Customers:



Wisconsin Electric provides electric utility service to a diversified base of customers in such industries as mining, paper, foundry, food products and machinery production, as well as to large retail chains.

Our largest retail electric customers are two iron ore mines located in the Upper Peninsula of Michigan. The combined electric energy sales to the two mines accounted for 5.2% and 6.5% of our total electric utility energy sales during 2009 and 2008, respectively. Effective January 1, 2008, the mines became eligible to receive electric service from Wisconsin Electric in accordance with tariffs approved by the MPSC. Prior to this, Wisconsin Electric had special negotiated power-sales contracts with these mines.

Sales to Wholesale Customers:

During 2009, Wisconsin Electric sold wholesale electric energy to two municipally owned systems, two rural cooperatives and two municipal joint action agency located in the states of Wisconsin and Michigan. Wholesale electric energy sales by Wisconsin Electric were also made to twelve other public utilities and power marketers throughout the region under rates approved by FERC. Edison Sault sold wholesale electric energy to one rural cooperative during 2009. Wholesale sales accounted for approximately 9.4% of our total electric energy sales and 5.4% of total electric operating revenues during 2009, compared with 9.9% of total electric energy sales and 3.6% of total electric operating revenues during 2008.

Electric System Reliability Matters:

Our electric sales are impacted by seasonal factors and varying weather conditions. We sell more electricity during the summer months because of the residential cooling load. Wisconsin Electric is a member of the RFC, a reliability council which has approved reliability standards setting forth the methodology for establishing planning reserve requirements and requiring the formation of PRSG. Wisconsin Electric is also a member of the Midwest PRSG, which was formed to establish planning reserve requirements. As a member of the Midwest PRSG, Wisconsin Electric was required to adhere to PSCW guidelines requiring an 18% planning reserve margin. In October 2008, the PSCW issued an order lowering the planning reserve margin requirement from 18% to 14.5% effective for planning year two and each year beyond, and the MISO calculated the planning reserve margin for the first planning year 2009-2010. The MPSC has not yet established guidelines in this area. We had adequate capacity to meet all of our firm electric load obligations during 2009 and expect to have adequate capacity to meet all of our firm obligations during 2010. For additional information, see Factors Affecting Results, Liquidity and Capital Resources in Item 7.

Electric Supply

Our electric supply strategy is to provide our customers with a diverse fuel mix that is expected to maintain a stable, reliable and affordable supply of electricity. We supply a significant amount of electricity to our customers from power plants that we own. We supplement our internally generated power supply with long-term power purchase agreements, including the Point Beach power purchase agreement discussed later in this report, and through spot purchases in the MISO Energy Markets.

Our installed capacity by fuel type as of December 31 is shown below:

| Dependable Capability in MW (a) |      |      |
|---------------------------------|------|------|
| 2009                            | 2008 | 2007 |
|                                 |      |      |

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|                                     |                     |                     |                     |
|-------------------------------------|---------------------|---------------------|---------------------|
| Coal (b) (c)                        | 3,131               | 3,247               | 3,247               |
| Natural Gas - Combined Cycle (d)    | 1,090               | 1,090               | 545                 |
| Natural Gas/Oil - Peaking Units (e) | 1,155               | 1,143               | 1,162               |
| Renewables (f)                      | <u>113</u>          | <u>113</u>          | <u>84</u>           |
| Total                               | <u><u>5,489</u></u> | <u><u>5,593</u></u> | <u><u>5,038</u></u> |

- (a) Dependable capability is the net power output under average operating conditions with equipment in an average state of repair as of a given month in a given year. The values were established by test and may change slightly from year to year.
- (b) OC 1 was placed in service on February 2, 2010, and our share of this unit's dependable capability is 515 MW. Bechtel is targeting the commercial operation of OC 2 by the end of August 2010, and our share of this unit's dependable capability will also be 515 MW.
- (c) In October 2009, Presque Isle Units 3 and 4 were retired. These units represented 116 MW of dependable capability.
- (d) The increase in 2008 as compared to 2007 reflects the May 2008 in-service of PWGS 2, which has a dependable capability of 545 MW.
- (e) The dual-fueled facilities generally burn oil only if natural gas is not available due to constraints on the natural gas pipeline and/or at the local gas distribution company that delivers gas to the plants.
- (f) Includes hydroelectric and wind generation. For purposes of measuring dependable capability, the 145 MW Blue Sky Green Field wind project has a dependable capability of 29 MW.

The table below indicates our sources of electric energy supply as a percentage of sales for the three years ended December 31, 2009, as well as an estimate for 2010:

|               | Estimate | Actual |       |       |
|---------------|----------|--------|-------|-------|
|               | 2010     | 2009   | 2008  | 2007  |
| Coal (a)      | 58.5%    | 52.3%  | 56.7% | 54.1% |
| Nuclear (b)   | N/A      | N/A    | N/A   | 17.3% |
| Wind          | 1.5%     | 1.1%   | 0.6 % | - %   |
| Hydroelectric | 1.3%     | 1.3%   | 1.4%  | 1.1%  |
|               | 8.0%     | 7.5%   | 5.2%  | 5.2%  |

|                                  |        |        |        |        |
|----------------------------------|--------|--------|--------|--------|
| Natural Gas -Combined<br>Cycle   |        |        |        |        |
| Natural Gas/Oil-Peaking<br>Units | 0.2%   | 0.2%   | 0.3%   | 1.0%   |
| Net Generation                   | 69.5%  | 62.4%  | 64.2%  | 78.7%  |
| Purchased Power (b)              | 30.5%  | 37.6%  | 35.8%  | 21.3%  |
| Total                            | 100.0% | 100.0% | 100.0% | 100.0% |

- (a) OC 1 was placed in service on February 2, 2010, and our share of this unit's dependable capability is 515 MW. Bechtel is targeting the commercial operation of OC 2 by the end of August 2010, and our share of this unit's dependable capability will also be 515 MW.
- (b) Beginning in 2007, nuclear generation decreased due to the sale of Point Beach and purchased power increased as a result of the entry into the associated power purchase agreement with the buyer.

Our average fuel and purchased power costs per MWh by fuel type for the years ended December 31 are shown below:

|                                    | 2009     | 2008     | 2007     |
|------------------------------------|----------|----------|----------|
| Coal                               | \$ 25.03 | \$ 22.95 | \$ 20.52 |
| Nuclear                            | N/A      | N/A      | \$ 5.83  |
| Natural Gas - Combined<br>Cycle    | \$ 51.67 | \$ 69.65 | \$ 61.27 |
| Natural Gas/Oil - Peaking<br>Units | \$121.18 | \$160.25 | \$112.49 |
| Purchased Power                    | \$ 41.90 | \$ 46.21 | \$ 45.19 |

Historically, the fuel costs for coal have been under long-term contracts, which helped with price stability. Coal and associated transportation services have seen greater volatility in pricing than typically experienced in these markets due to changes in the domestic and world-wide demand for coal and the impacts of diesel costs which are incorporated into fuel surcharges on rail transportation.

Natural gas costs have been volatile. We have a PSCW-approved hedging program to help manage our natural gas price risk. This hedging program is generally implemented on a 36-month forward-looking basis. Proceeds related to the natural gas hedging program are reflected in the 2009, 2008 and 2007 average costs of natural gas and purchased power shown above.

#### Coal-Fired Generation

#### Coal Supply:

We diversify the coal supply for our power plants by purchasing coal from mines in Wyoming, Pennsylvania and Colorado as well as from various other states. During 2010, 100% of our projected coal requirements of 11.6 million tons are under contracts which are not tied to 2010 market pricing fluctuations. In 2009, our coal-fired generation consisted of six operating plants with a dependable capability of approximately 3,131 MW. However, by the end of 2010, with the addition of OC 1 and the scheduled addition of OC 2, we expect our coal-fired generation to

have a dependable capability of 4,161 MW.

Following is a summary of the annual tonnage amounts for our principal long-term coal contracts by the month and year in which the contracts expire:

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| <u>Contract<br/>Expiration Date</u> | <u>Annual Tonnage</u><br>(Thousands) |
|-------------------------------------|--------------------------------------|
| Dec. 2010                           | 11,765                               |
| Dec. 2011                           | 9,480                                |
| Dec. 2012                           | 5,000                                |

#### Coal Deliveries:

Approximately 88% of our 2010 coal requirements are expected to be delivered by Wisconsin Electric-owned or leased unit trains. The unit trains will transport coal for the Oak Creek and Pleasant Prairie Power Plants from Wyoming mines, and transport coal for the Oak Creek expansion units from Pennsylvania and West Virginia. Coal from Colorado mines is also transported via rail to Lake Superior or Lake Michigan transfer docks and delivered by lake vessel to the Milwaukee harbor for Milwaukee-based power plants. Montana and Wyoming coal for Presque Isle Power Plant is transported via rail to Superior, Wisconsin, placed in dock storage and reloaded into lake vessels for plant delivery. Colorado coal bound for the Presque Isle Power Plant is shipped via rail to Lake Superior and Lake Michigan (Chicago) coal transfer docks, respectively, for lake vessel delivery to the plant.

Certain of our coal transportation contracts contain fuel cost adjustments that are tied to changes in a diesel fuel price index. Currently, diesel fuel contracts are not actively traded; therefore, we are using financial heating oil contracts to mitigate risk. The PSCW has approved a program that allows us to hedge up to 75% of our potential fuel for electric generation in order to help manage our risk of higher delivered cost of coal. The costs of this program are included in our fuel and purchased power costs.

During the fourth quarter of 2009, we reached a contingent agreement to sell our 25% interest in Edgewater Generating Unit 5 to WPL, which will become binding if we are unable to reach an agreement with a third party to sell our interest. We are continuing to negotiate with a third party to sell our interest in this unit. The completion of any sale will be subject to approval by the PSCW.

#### Environmental Matters:

For information regarding emission restrictions, especially as they relate to coal-fired generating facilities, see Factors Affecting Results, Liquidity and Capital Resources -- Environmental Matters in Item 7.

### Natural Gas-Fired Generation

Our natural gas-fired generation consists of five operating plants with a dependable capability of approximately 1,983 MW at December 31, 2009. We added PWGS 1 and PWGS 2, both natural gas-fired units with a dependable capability of 545 MW each, in July 2005 and May 2008, respectively.

We purchase natural gas for these plants on the spot market from gas marketers, utilities and producers and we arrange for transportation of the natural gas to our plants. We have firm and interruptible transportation, balancing and storage agreements intended to support the plants' variable usage.

The PSCW has approved a program that allows us to hedge up to 75% of our estimated gas usage for electric generation in order to help manage our natural gas price risk. The costs of this program are included in our fuel and purchased power costs.

### Oil-Fired Generation

Fuel oil is used for the combustion turbines at the Germantown Power Plant units 1-4, boiler ignition and flame stabilization at the Presque Isle Power Plant, and diesel engines at the Pleasant Prairie Power Plant, Valley Power Plant and at the Manistique facility at Edison Sault. Our oil-fired generation had a dependable capability of approximately 262 MW as of December 31, 2009. Our natural gas-fired peaking units have the ability to burn oil if natural gas is not available due to delivery constraints. Fuel oil requirements are purchased under agreements with suppliers.

### Renewable Generation

#### Hydroelectric:

Wisconsin Electric's hydroelectric generating system consists of 13 operating plants with a total installed capacity of approximately 88 MW and a dependable capability of approximately 57 MW as of December 31, 2009. Of these 13 plants, 12 plants (86 MW of installed capacity) have long-term licenses from FERC. The thirteenth plant, with an installed generating capacity of approximately 2 MW, does not require a license. Edison Sault's primary source of generation is its hydroelectric generating plant located on the St. Mary's River in Sault Ste. Marie, Michigan. The hydroelectric generating plant has a total dependable capability of approximately 27 MW. The water for this facility is under contract with the United States Army Corps of Engineers with tenure to December 31, 2075. However, the Secretary of the Army has the right to terminate the contract after December 31, 2050 by providing at least a five-year termination notice. No such notice can be given prior to December 31, 2045. Edison Sault pays for all water taken from the St. Mary's River at predetermined rates with a minimum annual payment of \$0.1 million. The total flow of water taken out of Lake Superior, which in effect is the flow of water in the St. Mary's River, is under the direction and control of the International Joint Commission, created by the Boundary Water Treaty of 1909 between the United States and Great Britain, now represented by Canada.

Hydroelectric generation is also purchased by Edison Sault under contract from the United States Army Corps of Engineers' hydroelectric generating plant located within the Soo Locks complex on the St. Mary's River in Sault Ste. Marie, Michigan. This 17 MW contract has tenure to November 1, 2040 and cannot be terminated by the United States government prior to November 1, 2030.

Wind:

Wisconsin Electric completed the Blue Sky Green Field wind project in May 2008. This project has 88 turbines, an installed capacity of approximately 145 MW and a current dependable capability of approximately 29 MW. In July 2008, Wisconsin Electric completed the purchase rights to a new wind farm site in central Wisconsin, Glacier Hills Wind Park, and filed a request for a CPCN with the PSCW in October 2008. We entered into a conditional turbine agreement for the new wind facility and filed a revised, lower cost estimate with the PSCW in May 2009 of \$335.2 million to \$413.5 million, excluding AFUDC. In January 2010, the PSCW approved the

CPCN. We currently expect to install up to 90 wind turbines with generating capacity of up to approximately 207 MW, subject to turbine selection and the final site configuration. We expect 2012 to be the first full year of operation.

Biomass:

In September 2009, we announced plans to construct a biomass-fueled power plant at Domtar Corporation's Rothschild, Wisconsin paper mill site. Wood, waste and sawdust will be used to produce approximately 50 MW of electricity and will also support Domtar's sustainable papermaking operations. We believe the biomass plant will be eligible for either the federal production tax credit or the federal 30% investment tax credit. We currently expect the plant to cost approximately \$250 million and to be completed during the fall of 2013, subject to regulatory approvals. We expect to file a request for a Certificate of Authority for the project in the first quarter of 2010.

Nuclear Generation

Point Beach:

Prior to September 28, 2007, Wisconsin Electric owned two 518 MW electric generating units at Point Beach in Two Rivers, Wisconsin. On September 28, 2007, Wisconsin Electric sold Point Beach to an affiliate of FPL for approximately \$924 million. Pursuant to the terms of the sale agreement, the buyer purchased Point Beach, its nuclear fuel and associated inventories, and assumed the obligation to decommission the plant.

A long-term power purchase agreement with the buyer became effective upon closing of the sale. Pursuant to this agreement, Wisconsin Electric is purchasing all of the energy produced by Point Beach. The power purchase agreement extends through 2030 for Unit 1 and 2033 for Unit 2. Based on the agreement, we will be paying the buyer a predetermined price per MWh for energy delivered. For additional information on the sale of Point Beach, see Note D -- Asset Sales, Divestitures and Discontinued Operations in the Notes to Consolidated Financial Statements in Item 8 and Nuclear Operations under Factors Affecting Results, Liquidity and Capital Resources in Item 7.

Used Nuclear Fuel Storage & Disposal:

For information concerning used nuclear fuel storage and disposal issues, see Nuclear Operations under Factors Affecting Results, Liquidity and Capital Resources in Item 7.

Power Purchase Commitments

We enter into short and long-term power purchase commitments to meet a portion of our anticipated electric energy supply needs. The following table identifies our power purchase commitments as of December 31, 2009 with

unaffiliated parties for the next five years:

| <u>Year</u> | <u>MW Under<br/>Power Purchase Commitments</u> |
|-------------|--|
| 2010        | 1,599  |
| 2011        | 1,599  |
| 2012        | 1,440  |
| 2013        | 1,269  |
| 2014        | 1,269  |

Approximately 1,030 MW per year relates to the Point Beach long-term power purchase agreement. Under this agreement, we pay a predetermined price per MWh for energy delivered according to a schedule included in the agreement. The balance of these power purchase commitments are tolling arrangements whereby we are responsible for the procurement, delivery and the cost of natural gas fuel related to specific units identified in the contracts.

#### Electric Transmission and Energy Markets

##### American Transmission Company

: ATC owns, maintains, monitors and operates electric transmission systems in Wisconsin, Michigan and Illinois. ATC's sole business is to provide reliable, economic electric transmission service to all customers in a fair and equitable manner. ATC is expected to provide comparable service to all customers, including Wisconsin Electric and Edison Sault, and to support effective competition in energy markets without favoring any market participant. ATC is regulated by FERC for all rate terms and conditions of service and is a transmission-owning member of MISO. MISO maintains operational control of ATC's transmission system, and Wisconsin Electric and Edison Sault are non-transmission owning members and customers of MISO. We owned approximately 26.2% of ATC as of December 31, 2009 and 2008.

##### MISO:

In connection with its status as a FERC approved RTO, MISO developed bid-based energy markets, which were implemented on April 1, 2005. In January 2009, MISO commenced the Energy and Operating Reserves Markets, which includes the bid-based energy markets and a new ancillary services market. For further information on MISO and the MISO Energy Markets, see Factors Affecting Results, Liquidity and Capital Resources -- Industry Restructuring and Competition - Electric Transmission and Energy Markets in Item 7.

##### Electric Hedging Programs:

We purchase some of the electricity needed to satisfy our current sales obligations in the MISO Energy Markets. Due to volatility in the price of market-based energy, we face potential financial exposure. We have PSCW approval to hedge up to 75% of a future month's predicted electricity need. This plan seeks to manage market price risk, as well as reduce price risks related to forced outages.

#### Electric Utility Operating Statistics

The following table shows certain electric utility operating statistics from 2005 to 2009 for electric operating revenues, MWh sales and customer data:

##### SELECTED CONSOLIDATED ELECTRIC UTILITY OPERATING DATA

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| Year Ended December 31              | 2009      | 2008      | 2007      | 2006      | 2005      |
|-------------------------------------|-----------|-----------|-----------|-----------|-----------|
| Operating Revenues (Millions)       | \$993.4   | \$977.1   |           |           |           |
| Residential                         |           |           | \$929.6   | \$883.2   | \$827.6   |
| Small Commercial/Industrial         | 881.8     | 890.6     | 861.7     | 814.8     | 746.1     |
| Large Commercial/Industrial         | 613.9     | 659.6     | 676.9     | 647.5     | 602.4     |
| Other - Retail                      | 21.7      | 21.2      | 19.7      | 19.3      | 17.9      |
| Total Retail Sales                  | 2,510.8   | 2,548.5   | 2,487.9   | 2,364.8   | 2,194.0   |
| Wholesale - Other                   | 98.3      | 58.9      | 95.1      | 78.0      | 94.7      |
| Resale - Utilities                  | 47.5      | 37.5      | 81.6      | 51.2      | 21.3      |
| Other Operating Revenues            | 55.7      | 41.5      | 41.1      | 35.4      | 39.7      |
| Total Operating Revenues            | \$2,712.3 | \$2,686.4 | \$2,705.7 | \$2,529.4 | \$2,349.7 |
| MWh Sales (Thousands)               |           |           |           |           |           |
| Residential                         | 8,122.9   | 8,448.1   | 8,586.6   | 8,322.7   | 8,562.7   |
| Small Commercial/Industrial         | 8,800.0   | 9,260.3   | 9,430.3   | 9,142.2   | 9,192.7   |
| Large Commercial/Industrial         | 9,348.4   | 10,903.0  | 11,245.6  | 11,173.1  | 11,687.5  |
| Other - Retail                      | 162.9     | 167.7     | 168.7     | 169.9     | 171.7     |
| Total Retail Sales                  | 26,434.2  | 28,779.1  | 29,431.2  | 28,807.9  | 29,614.6  |
| Wholesale - Other                   | 1,180.2   | 2,281.1   | 2,178.5   | 2,057.6   | 2,541.9   |
| Resale - Utilities                  | 1,548.9   | 881.0     | 1,434.5   | 1,025.7   | 313.7     |
| Total Sales                         | 29,163.3  | 31,941.2  | 33,044.2  | 31,891.2  | 32,470.2  |
| Customers - End of Year (Thousands) |           |           |           |           |           |
| Residential                         | 1,020.4   | 1,018.4   | 1,015.0   | 1,009.7   | 1,001.7   |
| Small Commercial/Industrial         | 116.8     | 116.2     | 114.4     | 112.3     | 110.5     |
| Large Commercial/Industrial         | 0.7       | 0.7       | 0.7       | 0.7       | 0.7       |
| Other                               | 2.5       | 2.5       | 2.4       | 2.5       | 2.4       |
| Total Customers                     | 1,140.4   | 1,137.8   | 1,132.5   | 1,125.2   | 1,115.3   |
| Customers - Average (Thousands)     | 1,138.5   | 1,134.8   | 1,128.5   | 1,120.5   | 1,109.7   |
| <u>Degree Days (a)</u>              |           |           |           |           |           |
| Heating (6,640 Normal)              | 6,825     | 7,073     | 6,508     | 6,043     | 6,628     |
| Cooling (698 Normal)                | 475       | 593       | 800       | 723       | 949       |



(a) As measured at Mitchell International Airport in Milwaukee, Wisconsin. Normal degree days are based upon a 20-year moving average.

## GAS UTILITY OPERATIONS

Our gas utility operations consist of Wisconsin Gas and the gas operations of Wisconsin Electric. Both companies are authorized to provide retail gas distribution service in designated territories in the State of Wisconsin, as established by indeterminate permits, CPCNs, or boundary agreements with other utilities. The two companies also transport customer-owned gas. Wisconsin Gas, the largest natural gas distribution utility in Wisconsin, operates throughout the state, including the City of Milwaukee. Wisconsin Electric's gas utility operates in three distinct service areas: west and south of the City of Milwaukee, the Appleton area and areas within Iron and Vilas Counties, Wisconsin.

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### Gas Deliveries

Our gas utility business is highly seasonal due to the heating requirements of residential and commercial customers. Annual gas sales are also impacted by the variability of winter temperatures.

Total gas therms delivered, including customer-owned transported gas, were approximately 2,183.9 million therms during 2009, a 4.0% decrease compared with 2008. At December 31, 2009, we were transporting gas for approximately 1,400 customers who purchased gas directly from other suppliers. Transported gas accounted for approximately 40.4% of the total volumes delivered during 2009, 39.8% during 2008 and 42.0% during 2007. We had approximately 1,060,200 and 1,056,400 gas customers at December 31, 2009 and 2008, respectively. Our peak daily send-out during 2009 was 1,788,742 Dth on January 15, 2009.

### Sales to Large Gas Customers:

We provide gas utility service to a diversified base of industrial customers who are largely within our electric service territory. Major industries served include the paper, food products and fabricated metal products industries. Fuel used for Wisconsin Electric's electric generation represents our largest transportation customer.

### Gas Deliveries Growth:

We currently forecast total retail therm deliveries (excluding natural gas deliveries for generation) to stay flat over the five-year period ending December 31, 2014 as new customer additions are expected to be offset by a reduction in the average use per customer. This forecast reflects a current year normalized sales level and normal weather.

### Competition

Competition in varying degrees exists between natural gas and other forms of energy available to consumers. A number of our large commercial and industrial customers are dual-fuel customers that are equipped to switch between natural gas and alternate fuels. We are allowed to offer lower-priced gas sales and transportation services to dual-fuel customers. Under gas transportation agreements, customers purchase gas directly from gas marketers and arrange with interstate pipelines and us to have the gas transported to their facilities. We earn substantially the same margin (difference between revenue and cost of gas) whether we sell and transport gas to customers or only transport their

gas.

Our ability to maintain our share of the industrial dual-fuel market depends on our success and the success of third-party gas marketers in obtaining long-term and short-term supplies of natural gas at competitive prices compared to other sources and in arranging or facilitating competitively-priced transportation service for those customers that desire to buy their own gas supplies.

Federal and state regulators continue to implement policies to bring more competition to the gas industry. While the gas utility distribution function is expected to remain a highly regulated, monopoly function, the sale of the natural gas commodity and related services are expected to remain subject to competition from third parties. It remains uncertain if and when the current economic disincentives for small customers to choose an alternative gas commodity supplier may be removed such that we begin to face competition for the sale of gas to our smaller firm customers.

#### Gas Supply, Pipeline Capacity and Storage

We have been able to meet our contractual obligations with both our suppliers and our customers despite periods of severe cold in recent heating seasons.

#### Pipeline Capacity and Storage:

The interstate pipelines serving Wisconsin originate in major gas producing areas of North America: the Oklahoma and Texas basins, the Gulf of Mexico, western Canada and the Rocky Mountains. We have contracted for long-term firm capacity from a number of these sources. This strategy reflects management's belief that overall supply security is enhanced by geographic diversification of the supply portfolios. We have extended our commitment on Guardian's original pipeline through December 2022. We have committed to purchase additional capacity through October 2023 on a new Guardian pipeline extension that was completed during 2009.

Due to the daily and seasonal variations in gas usage in Wisconsin, we have also contracted for substantial underground storage capacity, primarily in Michigan. Storage capacity, along with our gas purchase contracts, enables us to manage significant changes in daily demand and to optimize our overall gas supply and capacity costs. We generally inject gas into storage during the spring and summer months when demand is lower and withdraw it in the winter months. As a result, we can contract for less long-line pipeline capacity during periods of peak usage than would otherwise be

necessary, and can purchase gas on a more uniform daily basis from suppliers year-round. Each of these capabilities enables us to reduce our overall costs.

We hold firm daily transportation and storage capacity entitlements from pipelines and other service providers under long-term contracts.

#### Term Gas Supply:

We have contracts for firm supplies with terms in excess of 30 days with suppliers for gas acquired in the Chicago, Illinois market hub and in the producing areas discussed above. The pricing of the term contracts is based upon first of the month indices. Combined with our storage capability, management believes that the volume of gas under contract

is sufficient to meet our forecasted firm peak-day demand.

#### Secondary Market Transactions:

Capacity release is a mechanism by which pipeline long-line and storage capacity and gas supplies under contract can be resold in the secondary market. Local distribution companies, like Wisconsin Gas and Wisconsin Electric, must contract for capacity and supply sufficient to meet the firm peak-day demand of their customers. Peak or near peak demand days generally occur only a few times each year. Capacity release facilitates higher utilization of contracted capacity and supply during those times when the full contracted capacity and supply are not needed by the utility, helping to mitigate the fixed costs associated with maintaining peak levels of capacity and gas supply. Through pre-arranged agreements and day-to-day electronic bulletin board postings, interested parties can purchase this excess capacity and supply. The proceeds from these transactions are passed through to rate payers, subject to the Wisconsin Electric and Wisconsin Gas GCRMs. During 2009, we continued our active participation in the capacity release market. See Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters in Item 7 for information on the GCRMs.

#### Spot Market Gas Supply:

We expect to continue to make gas purchases in the 30-day spot market as price and other circumstances dictate. We have supply relationships with a number of sellers from whom we purchase spot gas.

#### Hedging Gas Supply Prices:

We have PSCW approval to hedge (i) up to 45% of planned flowing gas supply using NYMEX based natural gas options, (ii) up to 15% of planned flowing gas supply using NYMEX based natural gas future contracts and (iii) up to 35% of planned storage withdrawals using NYMEX based natural gas options. Those approvals allow both Wisconsin Electric and Wisconsin Gas to pass 100% of the hedging costs (premiums and brokerage fees) and proceeds (gains and losses) to rate payers through their respective GCRMs. Hedge targets (volumes) are provided annually to the PSCW as part of each company's three-year gas supply plan and risk management filing.

To the extent that opportunities develop and our physical supply operating plans will support them, we also have PSCW approval to utilize NYMEX based natural gas derivatives to capture favorable forward market price differentials. That approval provides for 100% of the related proceeds to accrue to our GCRMs.

#### Gas Utility Operating Statistics

The following table shows certain gas utility operating statistics from 2005 to 2009 for gas operating revenues, therms delivered and customer data:

#### SELECTED CONSOLIDATED GAS UTILITY OPERATING DATA

| Year Ended December 31        | 2009    | 2008      | 2007    | 2006    | 2005    |
|-------------------------------|---------|-----------|---------|---------|---------|
| Operating Revenues (Millions) |         |           |         |         |         |
| Residential                   | \$856.6 | \$1,057.6 | \$934.3 | \$862.4 | \$898.9 |
| Commercial/Industrial         | 442.9   | 572.4     | 485.4   | 443.8   | 465.4   |

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|                          |                  |                  |                  |                  |                  |
|--------------------------|------------------|------------------|------------------|------------------|------------------|
| Interruptible            | 11.9             | 21.3             | 17.5             | 17.0             | 20.4             |
| Total Retail Gas Sales   | 1,311.4          | 1,651.3          | 1,437.2          | 1,323.2          | 1,384.7          |
| Transported Gas          | 44.8             | 47.2             | 48.4             | 47.8             | 46.3             |
| Other Operating Revenues | 11.7             | (3.9)            | (4.4)            | 48.9             | (13.5)           |
| Total Operating Revenues | <u>\$1,367.9</u> | <u>\$1,694.6</u> | <u>\$1,481.2</u> | <u>\$1,419.9</u> | <u>\$1,417.5</u> |

Therms Delivered (Millions)

|                        |                |                |                |                |                |
|------------------------|----------------|----------------|----------------|----------------|----------------|
| Residential            | 803.4          | 841.8          | 791.7          | 727.9          | 791.0          |
| Commercial/Industrial  | 479.4          | 503.2          | 461.9          | 435.9          | 460.7          |
| Interruptible          | 19.1           | 23.0           | 22.7           | 21.3           | 23.4           |
| Total Retail Gas Sales | <u>1,301.9</u> | <u>1,368.0</u> | <u>1,276.3</u> | <u>1,185.1</u> | <u>1,275.1</u> |
| Transported Gas        | <u>882.0</u>   | <u>905.8</u>   | <u>921.6</u>   | <u>843.8</u>   | <u>893.7</u>   |
| Total Therms Delivered | <u>2,183.9</u> | <u>2,273.8</u> | <u>2,197.9</u> | <u>2,028.9</u> | <u>2,168.8</u> |

Customers - End of Year (Thousands)

|                       |                |                |                |                |                |
|-----------------------|----------------|----------------|----------------|----------------|----------------|
| Residential           | 967.7          | 963.9          | 957.9          | 951.0          | 940.7          |
| Commercial/Industrial | 91.1           | 91.0           | 90.2           | 88.9           | 87.5           |
| Interruptible         | 0.1            | 0.1            | 0.1            | 0.1            | 0.1            |
| Transported Gas       | 1.3            | 1.4            | 1.3            | 1.4            | 1.4            |
| Total Customers       | <u>1,060.2</u> | <u>1,056.4</u> | <u>1,049.5</u> | <u>1,041.4</u> | <u>1,029.7</u> |

|                                 |         |         |         |         |         |
|---------------------------------|---------|---------|---------|---------|---------|
| Customers - Average (Thousands) | 1,055.6 | 1,050.2 | 1,042.8 | 1,033.3 | 1,019.8 |
|---------------------------------|---------|---------|---------|---------|---------|

Degree Days (a)

|                        |       |       |       |       |       |
|------------------------|-------|-------|-------|-------|-------|
| Heating (6,640 Normal) | 6,825 | 7,073 | 6,508 | 6,043 | 6,628 |
|------------------------|-------|-------|-------|-------|-------|

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a) As measured at Mitchell International Airport in Milwaukee, Wisconsin. Normal degree days are based upon a 20-year moving average.

OTHER UTILITY OPERATIONS

Steam Utility Operations:

Wisconsin Electric's steam utility generates, distributes and sells steam supplied by its Valley and Milwaukee County Power Plants. Wisconsin Electric operates a district steam system in downtown Milwaukee and the near south side of Milwaukee. Steam is supplied to this system from Wisconsin Electric's Valley Power Plant, a coal-fired cogeneration facility. Wisconsin Electric also operates the steam production and distribution facilities of the Milwaukee County Power Plant located on the Milwaukee County Grounds in Wauwatosa, Wisconsin.

Annual sales of steam fluctuate from year to year based upon system growth and variations in weather conditions. During 2009, the steam utility had \$39.1 million of operating revenues from the sale of 2,932 million pounds of steam compared with \$40.3 million of operating revenues from the sale of 3,081 million pounds of steam

during 2008. As of December 31, 2009 and 2008, steam was used by approximately 465 customers, respectively, for processing, space heating, domestic hot water and humidification.

#### Water Utility Operations

: In April 2009, we sold our water utility to the City of Mequon, Wisconsin for approximately \$14.5 million. For further information on the sale of the water utility operations, see Note D -- Asset Sales, Divestitures and Discontinued Operations in the Notes to Consolidated Financial Statements in Item 8.

#### UTILITY RATE MATTERS

See Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters in Item 7.

#### NON-UTILITY ENERGY SEGMENT

Our non-utility energy segment is involved primarily in the design and construction of new generating capacity under our PTF strategy. As of December 31, 2009, our PTF assets represented virtually all of our non-utility energy segment assets.

During 2000, we performed a comprehensive review of our existing portfolio of businesses and began implementing a strategy of divesting many of our non-utility energy segment businesses. Since 2000, we have sold our interest in many of our non-utility energy assets with proceeds from these sales totaling approximately \$631.8 million.

#### We Power

We Power, through wholly owned subsidiaries, has designed and is constructing approximately 2,320 MW of new generation in Wisconsin, which is the key component of our PTF strategy. This new generation consists of approximately 1,230 MW of new generating capacity from OC 1 and OC 2, and 1,090 MW of generating capacity related to PWGS 1 and PWGS 2. PWGS 1 and PWGS 2 were placed in service in July 2005 and May 2008, respectively. In November 2005, two unaffiliated entities collectively purchased an ownership interest of approximately 17%, or 200 MW, in OC 1 and OC 2. Similar to the generating capacity at PWGS 1 and PWGS 2, We Power will own the remaining 1,030 MW of generating capacity currently being constructed and will lease this capacity to Wisconsin Electric. As of December 31, 2009, we had approximately \$1.8 billion of CWIP related to the construction of OC 1 and OC 2. OC 1 was placed into service on February 2, 2010. Bechtel is targeting the commercial operation of OC 2 by the end of August 2010. For further information about our PTF strategy, see Factors Affecting Results, Liquidity and Capital Resources -- Power the Future in Item 7.

#### Wisvest LLC

Wisvest was originally formed to develop, own and operate electric generating facilities and to invest in other energy-related entities. As a result of the change in corporate strategy to focus on our PTF strategy, Wisvest has discontinued its development activity. As of December 31, 2009, Wisvest's sole operating asset and investment is Wisvest Thermal Energy Services, which provides chilled water services to the Milwaukee Regional Medical Center.

OTHER NON-UTILITY OPERATIONS

Wispark LLC

Wispark develops and invests in real estate, and as of December 31, 2009, had \$46.2 million in real estate holdings. Wispark has developed several business parks and other commercial real estate projects, primarily in southeastern Wisconsin.

Wisconsin Energy Capital Corporation

This entity engages in investing and financing activities, including advances to affiliated companies.

REGULATION

Wisconsin Energy Corporation

As required by PUHCA 2005, enacted under the Energy Policy Act, Wisconsin Energy notified FERC of its status as a holding company and sought from FERC exemption from the requirements of PUHCA 2005. In June 2006, Wisconsin Energy received notice from FERC confirming its status as a holding company and granting such exemption.

Non-Utility Asset Cap:

Pursuant to the non-utility asset cap provisions of Wisconsin's public utility holding company law, the sum of certain assets of all non-utility affiliates in a holding company system may not exceed 25% of the assets of all public utility affiliates. However, among other items, the law exempts energy-related assets, including the generating plants being constructed by We Power as part of our PTF strategy and assets used for providing environmental engineering services and for processing waste materials, from being counted against the asset cap provided that they are employed in qualifying businesses. As a result of these exemptions, our non-utility assets are significantly below the non-utility asset cap as of December 31, 2009.

Utility Energy Segment

Due to the Energy Policy Act's enactment of PUHCA 2005 as noted above, Wisconsin Electric was also required to notify FERC of its status as a holding company by reason of its ownership interest in ATC and to seek exemption from the requirements of PUHCA 2005 from FERC. In June 2006, Wisconsin Electric received notice from FERC confirming its status as a holding company and granting such exemption.

Wisconsin Electric and Edison Sault are subject to the Energy Policy Act and the corresponding regulations developed by certain federal agencies. The Energy Policy Act, among other things, made electric utility industry consolidation more feasible, authorized FERC to review proposed mergers and the acquisition of generation facilities, changed the FERC regulatory scheme applicable to qualifying co-generation facilities and modified certain other aspects of energy regulations and Federal tax policies applicable to Wisconsin Electric and Edison Sault. Additionally, the Energy Policy Act created an Electric Reliability Organization to be overseen by FERC, which established mandatory electric reliability standards, replacing the voluntary standards developed by the North American Electric Reliability Corporation, and which has the authority to levy monetary sanctions for failure to comply with the new standards.

Wisconsin Electric and Wisconsin Gas are subject to the regulation of the PSCW as to retail electric, gas and steam rates in the state of Wisconsin, standards of service, issuance of securities, construction of certain new facilities, transactions with affiliates, billing practices and various other matters. Wisconsin Electric is subject to regulation of the PSCW as to certain levels of short-term debt obligations. Wisconsin Electric and Edison Sault are both subject to the regulation of the MPSC as to the various matters associated with retail electric service in the state of Michigan, except as to the issuance of securities in the ordinary course of business, construction of certain new facilities, levels of short-term debt obligations and advance approval of transactions with affiliates in the ordinary course of business. Wisconsin Electric's hydroelectric facilities are regulated by FERC. Wisconsin Electric and Edison Sault are subject to regulation of FERC with respect to wholesale power service, electric reliability requirements and accounting. Edison Sault is subject to regulation of FERC with respect to the issuance of certain securities. For information on how rates are set for our regulated entities, see Utility Rates and Regulatory Matters under Factors Affecting Results, Liquidity and Capital Resources in Item 7.

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The following table compares the source of our utility energy segment operating revenues by regulatory jurisdiction for each of the three years in the period ended December 31, 2009:

|                                  | 2009                  |         | 2008      |         | 2007      |         |
|----------------------------------|-----------------------|---------|-----------|---------|-----------|---------|
|                                  | Amount                | Percent | Amount    | Percent | Amount    | Percent |
|                                  | (Millions of Dollars) |         |           |         |           |         |
| Wisconsin - Retail               |                       |         |           |         |           |         |
| Electric                         | \$2,379.2             | 57.8%   | \$2,416.8 | 54.8%   | \$2,331.1 | 55.1%   |
| Gas                              | 1,367.9               | 33.2%   | 1,694.6   | 38.3%   | 1,481.2   | 35.1%   |
| Steam                            | 39.1                  | 0.9%    | 40.3      | 0.9%    | 35.1      | 0.8%    |
| Total                            | 3,786.2               | 91.9%   | 4,151.7   | 94.0%   | 3,847.4   | 91.0%   |
| Michigan - Retail                |                       |         |           |         |           |         |
| Electric                         | 187.2                 | 4.6%    | 173.2     | 3.9%    | 198.0     | 4.7%    |
| FERC - Wholesale                 |                       |         |           |         |           |         |
| Electric                         | 145.9                 | 3.5%    | 96.4      | 2.1%    | 176.7     | 4.2%    |
| Total Utility Operating Revenues | \$4,119.3             | 100.0%  | \$4,421.3 | 100.0%  | \$4,222.1 | 100.0%  |

Total flow of water to Edison Sault's hydroelectric generating plant is under the control of the International Joint Commission, created by the Boundary Water Treaty of 1909 between the United States and Great Britain, now represented by Canada. The operations of Wisconsin Electric, Wisconsin Gas and Edison Sault are also subject to regulations, where applicable, of the EPA, the WDNR, the MDEQ and the Michigan Department of Natural Resources.

#### Public Benefits and Renewable Portfolio Standard

In March 2006, Wisconsin revised the requirements for renewable energy generation by enacting Act 141. Act 141 defines "baseline renewable percentage" as the average of an energy provider's renewable energy percentage for 2001,

2002 and 2003. A utility's renewable energy percentage is equal to the amount of its total retail energy sales that are provided by renewable sources. Wisconsin Electric's baseline renewable energy percentage is 2.27%. Under Act 141, Wisconsin Electric could not decrease its renewable energy percentage for the years 2006-2009, and for the years 2010-2014, it must increase its renewable energy percentage at least two percentage points to a level of 4.27%. Act 141 further requires that for the year 2015 and beyond, the renewable energy percentage must increase at least six percentage points above the baseline to a level of 8.27%. Act 141 establishes a goal that 10% of all electricity consumed in Wisconsin be generated by renewable resources by December 31, 2015. Act 141 also redirects the administration of energy efficiency, conservation and renewable programs from the DOA back to the PSCW and/or contracted third parties. In addition, Act 141 requires that 1.2% of utilities' annual operating revenues be used to fund these programs. In July 2008, the Governor of Wisconsin's Task Force on Global Warming, which was established in 2007, issued a final report that recommended that the energy efficiency goal be based on achieving efficiency resulting in a 2% reduction in electric load annually starting in 2015 rather than a goal based on a percent of revenue.

The Task Force's report also includes an increased renewable portfolio standard. Under the Task Force's recommendations, the renewable portfolio standard would increase to 10% by 2013, 20% by 2020 and 25% by 2025.

In December 2009, legislation covering the Task Force recommendations was introduced in the Wisconsin legislature. We are working within the context of the Task Force to provide comments where we believe the proposed legislation deviates from the Task Force recommendations.

Public Act 295 enacted in Michigan calls for the implementation of a renewable portfolio standard by 2015 and energy optimization (efficiency) targets up to 1% annually by 2015. Public Act 295 specifically calls for current recovery of costs incurred to meet the standards and provides for ongoing review and revision to assure the measures taken are cost-effective.

For additional information on Act 141 and current renewable projects, see Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters - Renewables, Efficiency and Conservation and Utility Rates and Regulatory Matters - Renewable Energy Portfolio in Item 7.

## Non-Utility Energy Segment

We Power was formed to design, construct, own and lease the new generating capacity in our PTF strategy. We Power owns the interests in the companies constructing this new generating capacity (collectively, the We Power project companies). When complete, these facilities will be leased on a long-term basis to Wisconsin Electric. We Power has received determinations from FERC that upon the transfer of the facilities by lease to Wisconsin Electric, the We Power project companies will not be deemed public utilities under the Federal Power Act and thus will not be subject to FERC's jurisdiction.

The Energy Policy Act and corresponding rules developed by FERC required us to seek FERC authorization to allow Wisconsin Electric to lease OC 1, OC 2 and PWGS 2 from We Power. We received this authorization from FERC in December 2006. We were not required to request similar approval for the PWGS 1 lease between We Power and Wisconsin Electric as this unit was in service prior to the enactment of the Energy Policy Act.

In addition, for a short period prior to the transfer of each generation unit to Wisconsin Electric, We Power will be engaged in the sale of test power, a FERC jurisdictional transaction. We Power received approval from FERC for the



sale of test power to Wisconsin Electric from PWGS 1, PWGS 2 and OC 1 and for the transfer of any FERC jurisdictional facilities at Port Washington to Wisconsin Electric and/or ATC. We Power submitted its application seeking approval from FERC to sell test power from OC 2 in January 2010. Environmental permits necessary for operating the facilities are the responsibility of the operating entity, Wisconsin Electric.

## ENVIRONMENTAL COMPLIANCE

Our operations are subject to extensive environmental regulations by state and federal environmental agencies governing air and water quality, hazardous and solid waste management, environmental remediation, and management of natural resources. Costs associated with complying with these requirements are significant. Additional future environmental statutes and regulations or revisions to existing laws, including for example, additional regulation of greenhouse gas emissions, coal ash, air emissions or wastewater discharges, could significantly increase these environmental compliance costs.

Expenditures for environmental compliance and remediation issues are included in anticipated capital expenditures described in Liquidity and Capital Resources in Item 7. For discussion of additional environmental issues, see Environmental Matters in Item 3. For further information concerning air and water quality standards and rulemaking initiated by the EPA, including estimated costs of compliance, see Factors Affecting Results, Liquidity and Capital Resources -- Environmental Matters in Item 7. For a discussion of matters related to certain solid waste and coal-ash landfills, manufactured gas plant sites and air quality, see Note S -- Commitments and Contingencies in the Notes to Consolidated Financial Statements in Item 8.

Compliance with federal, state and local environmental protection requirements resulted in capital expenditures by Wisconsin Electric of approximately \$188 million in 2009 compared with \$135 million in 2008. Expenditures incurred during 2008 and 2009 primarily included costs associated with the installation of pollution abatement facilities at Wisconsin Electric's power plants. These expenditures are expected to approximate \$300 million during 2010, reflecting NO<sub>x</sub>, SO<sub>2</sub> and other pollution control equipment needed to comply with various rules promulgated by the EPA. Operation, maintenance and depreciation expenses for fly ash removal equipment and other environmental protection systems were approximately \$66.7 million and \$67.2 million during 2009 and 2008, respectively.

### Coal-Ash Landfills

We currently have a successful program of beneficial utilization for substantially all of our coal combustion products, including fly ash, bottom ash and synthetic gypsum, which avoids the need for disposal in specially-designed landfills. Some early designed and constructed coal-ash landfills, which we used prior to developing this program, may allow the release of low levels of constituents resulting in the need for various levels of remediation. Where we have become aware of these conditions, efforts have been made to define the nature and extent of any release, and work has been performed to address these conditions. Sites currently undergoing remediation include the following:

### Oak Creek North Landfill:

Groundwater impairments at this landfill, located in the City of Oak Creek, Wisconsin, prompted Wisconsin Electric to investigate, during 1998, the condition of the existing cover and other conditions at the site. Surface water drainage improvements were effectively implemented at this site during 1999 and 2000. The approved remediation plan was coordinated with activities associated with the construction of the Oak Creek

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expansion. Currently there is a temporary cap installed which is being used as laydown area and parking. When construction activities are completed, a permanent cap will be installed.

### South Oak Creek Landfill:

Groundwater impairments at this landfill, located in the City of Oak Creek, Wisconsin, prompted Wisconsin Electric to begin investigation in 2009 for the source of impacts identified in monitoring wells on the site and the surrounding area. Preliminary results indicate that the groundwater impacts may be naturally occurring, or are from another source. Soils from construction of the Oak Creek expansion were added to the existing cover during 2005 and 2006 to increase the thickness of cover materials. A landfill closure application will be completed when the construction documentation report for activities associated with the Oak Creek expansion is submitted to the WDNR.

## OTHER

### Research and Development:

We had immaterial research and development expenditures in the last three years, primarily for improvement of service and abatement of air and water pollution by our electric utility operations. Research and development activities include work done by employees, consultants and contractors, plus sponsorship of research by industry associations.

### Employees:

As of December 31, 2009, we had the following number of employees:

|                            | <u>Total<br/>Employees</u> | <u>Represented<br/>Employees</u> |
|----------------------------|----------------------------|----------------------------------|
| Utility Energy Segment     |                            |                                  |
| Wisconsin Electric         | 4,123                      | 2,720                            |
| Wisconsin Gas              | 476                        | 347                              |
| Edison Sault               | 61                         | 43                               |
| Total                      | <u>4,660</u>               | <u>3,110</u>                     |
| Non-Utility Energy Segment | 27                         | -                                |
| Other                      | 5                          | -                                |
| Total Employees            | <u><u>4,692</u></u>        | <u><u>3,110</u></u>              |

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The employees represented under labor agreements were with the following bargaining units as of December 31, 2009:

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|   | Number of<br>Employees      | Expiration Date of<br>Current Labor<br>Agreement |
|---|-----------------------------|--|
|   | <u>                    </u> | <u>                    </u>                      |
| Wisconsin Electric  |                             |  |
| Local 2150 of International<br>Brotherhood of Electrical<br>Workers | 1,925                       | August 15, 2010                                  |
| Local 317 of International Union<br>of Operating Engineers          | 491                         | March 31, 2011                                   |
| Local 2006 Unit 5 of United Steel<br>Workers                        | 168                         | November 1, 2011                                 |
| Local 510 of International<br>Brotherhood of Electrical<br>Workers  | 136                         | April 30, 2010                                   |
| Total Wisconsin Electric  | <u>2,720</u>                |  |
| Wisconsin Gas   |                             |  |
| Local 2150 of International<br>Brotherhood of Electrical<br>Workers | 89                          | August 15, 2010                                  |
| Local 2006 Unit 1 of United Steel<br>Workers                        | 121                         | December 31,<br>2010                             |
| Local 2006 Unit 2 of United Steel<br>Workers                        | 131                         | December 31,<br>2010                             |
| Local 2006 Unit 3 of United Steel<br>Workers                        | 6                           | February 28, 2011                                |
| Total Wisconsin Gas   | <u>347</u>                  |  |
| Edison Sault  |                             |  |
| Local 13547 of United Steel<br>Workers<br>of America                | 43                          | October 22, 2010                                 |
| Total Edison Sault  | <u>43</u>                   |  |
| Total Represented<br>Employees                                      | <u>3,110</u>                |  |

## ITEM 1A. RISK FACTORS

Our business is significantly impacted by governmental regulation.

We are subject to significant state, local and federal governmental regulation. We are subject to the regulation of the PSCW as to retail electric, gas and steam rates in the State of Wisconsin, standards of service, issuance of securities, short-term debt obligations, construction of certain new facilities, transactions with affiliates, billing practices and various other matters. In addition, we are subject to the regulation of the MPSC as to the various matters associated with retail electric service in the state of Michigan, except as to the issuance of securities in the ordinary course of business, construction of certain new facilities, levels of short-term debt obligations and advance approval of transactions with affiliates in the ordinary course of business. Further, Wisconsin Electric's hydroelectric facilities are regulated by FERC, and FERC also regulates our wholesale power service practices and electric reliability requirements. Our significant level of regulation imposes restrictions on our operations and causes us to incur substantial compliance costs.

We are obligated to comply in good faith with all applicable governmental rules and regulations. If it is determined that we failed to comply with any applicable rules or regulations, whether through new interpretations or applications of the regulations or otherwise, we may be liable for customer refunds, penalties and other amounts, which could materially and adversely affect our results of operations and financial condition.

We estimate that within our regulated energy segment, approximately 88% of our electric revenues are regulated by the PSCW, 7% are regulated by the MPSC and the balance of our electric revenues is regulated by FERC. All of our natural gas and steam revenues are regulated by the PSCW. Our ability to obtain rate adjustments in the future is dependent upon regulatory action, and there can be no assurance that we will be able to obtain rate adjustments in the future that will allow us to recover our costs and expenses and to maintain our current authorized rates of return.

We believe we have obtained the necessary permits, approvals and certificates for our existing operations and that our respective businesses are conducted in accordance with applicable laws; however, the impact of any future revision or changes in interpretations of existing regulations or the adoption of new laws and regulations applicable to us cannot be predicted. Changes in regulation, interpretations of regulations or the imposition of additional regulations could influence our operating environment and may result in substantial compliance costs.

Factors beyond our control could adversely affect project costs and completion of OC 2 and other construction projects.

Under our PTF strategy, we expect to meet a significant portion of our future generation needs through the construction of two 545 MW natural gas-fired generating units at PWGS and two 615 MW coal-fired generating units (of which we own 515 MW each) located adjacent to our existing Oak Creek Power Plant. PWGS 1 and PWGS 2, which have a dependable capability of 545 MW each, were placed in service in July 2005 and May 2008, respectively. OC 1 was placed into service on February 2, 2010. Bechtel is targeting the commercial operation of OC 2 by the end of August 2010.

Large construction projects of this type, as well as the construction of renewable energy generation and environmental improvements, are subject to usual construction risks over which we will have limited or no control and which might adversely affect project costs and completion time. These risks include, but are not limited to, shortages of, the ability to obtain or the cost of labor or materials; the ability of the general contractor or subcontractors to perform under their contracts; strikes; adverse weather conditions; the ability to obtain necessary operating permits in a timely manner; legal challenges; changes in applicable law or regulations; adverse interpretation or enforcement of permit conditions, laws and regulations by courts or the permitting agencies; other governmental actions; and events in the global economy.

Upon commencement of the commissioning of OC 2, we will be selling test power into the MISO Energy Markets. The amount we receive for the sale of this power will be affected by the market price for energy at the time of sale.

If final costs of the Oak Creek expansion are within 5% of the costs initially approved by the PSCW, and the additional costs are deemed to be prudent by the PSCW, the final lease payments for the Oak Creek expansion to be recovered from Wisconsin Electric's ratepayers would be adjusted to reflect the actual construction costs. Costs above the 5% cap would not be included in lease payments or recovered from customers absent a finding by the PSCW that such costs were prudently incurred and were the result of force majeure conditions, an excused event and/or an event of loss.

In December 2008, Bechtel, the contractor of the Oak Creek expansion under a fixed price contract, submitted claims for schedule and cost relief related to the delay of the in-service dates for OC 1 and OC 2. Through an amended claim filed on October 30, 2009, Bechtel was seeking cost relief of \$517.5 million and seven months of relief from liquidated damages for OC 1 and four months of relief for OC 2. These claims, as well as claims submitted by ERS, had been submitted to binding arbitration. Effective December 16, 2009, ERS and Bechtel entered into the Settlement Agreement to resolve these claims, under which, among other things, ERS will pay to Bechtel \$72 million. If the PSCW does not allow Wisconsin Electric to collect our share of this settlement in rates, as well as other additional amounts incurred above the costs initially approved by the PSCW, our results of operations could be adversely affected.

We face significant costs of compliance with existing and future environmental regulations.

Our operations are subject to extensive environmental regulations by state and federal environmental agencies governing, among other things, air emissions such as CO<sub>2</sub>, SO<sub>2</sub>, NO<sub>x</sub>, fine particulates and mercury; water discharges and management of hazardous, toxic and solid wastes and substances. We incur significant expenditures in complying with these environmental requirements, including expenditures for the installation of pollution control equipment, environmental monitoring, emissions fees and permits at all of our facilities.

Existing environmental regulations may be revised or new laws or regulations may be adopted which could result in significant additional expenditures, operating restrictions on our facilities and increased compliance costs. In addition, the operation of emission control equipment and further regulations on our intake and discharge of water could increase our operating costs and could reduce the generating capacity of our power plants. In the event we are not able to recover all of our environmental expenditures from our customers in the future, our results of operations could be adversely affected.

Our electric and gas utility businesses are also subject to significant liabilities related to the investigation and remediation of environmental contamination at certain of our current and former facilities, and at third-party owned sites. Due to the potential for imposition of stricter standards and greater regulation in the future and the possibility that other potentially responsible parties may not be financially able to contribute to cleanup costs, conditions may change or additional contamination may be discovered, our remediation costs could increase, and the timing of our capital and/or operating expenditures in the future may accelerate.

In addition, we may also be subject to potential liability in connection with the environmental condition of the facilities that we have previously owned and operated, regardless of whether the liabilities arose before, during or after the time we owned or operated the facilities. If we fail (or failed) to comply with environmental laws and regulations

or cause (or caused) harm to the environment or persons, even if caused by factors beyond our control, that failure or harm may result in the assessment of civil or criminal penalties and damages against us. The incurrence of a material environmental liability or a material judgment in any action for personal injury or property damage related to environmental matters could have a significant adverse effect on our results of operations and financial condition.

We could face significant costs if coal ash is regulated as a hazardous waste.

We currently have a successful program of beneficial utilization for substantially all of our coal combustion products, including fly ash, bottom ash and synthetic gypsum, which avoids the need for disposal in specially-designed landfills. Both Wisconsin and Michigan have regulations governing the use and disposal of these materials. Recently, however, the EPA stated it is considering classifying coal ash as hazardous waste. If coal ash is classified as hazardous waste, it could have a material adverse effect on our ability to continue our current program. Curtailing our program could result in the loss of a revenue stream that helps to offset the cost of pollution control equipment and the activities necessary to collect the coal ash.

In addition, if coal ash is classified as hazardous waste and we terminate our coal ash utilization program, we could be required to dispose of the coal ash at a significant cost to the Company.

We may face significant costs to comply with the regulation of greenhouse gas emissions.

Federal and state legislative and regulatory proposals have been introduced to regulate the emission of greenhouse gases, particularly CO<sub>2</sub>, and the President and his administration have made it clear that they are focused on reducing such emissions through legislation and/or regulation. In addition, there have been international efforts

seeking legally binding reductions in emissions of greenhouse gases.

We believe that future governmental legislation and/or regulation will require us either to limit greenhouse gas emissions from our operations or to purchase allowances for such emissions. However, we cannot currently predict with any certainty what form these future regulations will take, the stringency of the regulations or when they will become effective. Legislation continues to be considered in the United States Congress that would compel greenhouse gas emission reductions. The American Clean Energy and Security Act of 2009 passed the U.S. House of Representatives in June 2009. The bill, among other things, (i) establishes a federal renewable energy standard; (ii) permits energy efficiency measures to satisfy part of the renewable energy standard; and (iii) establishes a cap-and-trade program to reduce greenhouse gas emissions from various sectors of the economy, including electric and natural gas utilities. Similar legislation is currently being considered in the U.S. Senate, and could result in the passage of enforceable federal standards, such as a cap-and-trade program, governing greenhouse gas emissions.

Legislation to regulate greenhouse gases and establish renewable and efficiency standards is also being considered on the state level. The state of Michigan has enacted legislation that calls for the implementation of a renewable portfolio standard by 2015 and energy optimization (efficiency) targets up to 1% annually by 2015. The state of Wisconsin is currently considering similar legislation addressing renewable energy and efficiency standards. In addition, the Governors of both Michigan and Wisconsin have signed on to the "Midwestern Greenhouse Gas Reduction Accord" and the associated "platform" document developed through the Midwestern Governors Association. These state and regional initiatives could lead to legislation and regulation of greenhouse gas emissions that could be implemented sooner and/or independent of federal regulation, and could be more stringent than any federal legislation that is

adopted.

In addition to these federal and state legislative efforts, the EPA is pursuing regulation of greenhouse gases using its existing authority under the CAA. On December 7, 2009, the EPA issued its long-expected endangerment finding. This determination provides that the atmospheric mix of six greenhouse gases endanger public health and welfare. The determination specifically addresses only the contribution to air pollution of greenhouse gas emissions from motor vehicles and itself has no immediate regulatory effect. However, in combination with a separate EPA rulemaking that will establish limits on greenhouse gas emissions from new motor vehicles, the endangerment finding sets in motion a regulatory process that would likely lead to widespread regulation of greenhouse gas emissions from stationary sources, including electric generating units, absent legislative or other intervention by the Administration. Regulation of greenhouse gas emissions from power plants will impact our ability to do maintenance or modify our existing facilities, and permit new facilities.

In September 2009, the EPA issued two proposals intended to provide guidance on, and effectively change, how the CAA's existing permitting requirements could be applied to sources of greenhouse gas emissions in all sectors of the economy, including major stationary sources of air pollutants like electric generating plants. The endangerment finding, the regulation of greenhouse gas emissions from motor vehicles and these two additional proposals would provide a framework for the EPA to regulate greenhouse gas emissions from major sources under the CAA.

Some states and environmental groups are also bringing lawsuits against electric utilities and others to force reductions in greenhouse gas emissions. A decision in the U.S. Court of Appeals for the Second Circuit has made it easier for lawsuits to move forward based upon the alleged public nuisance of climate change. The Second Circuit ruled that the plaintiffs in that case have standing to file suit against six electric power corporations for their contribution to the alleged public nuisance of climate change, and that the court's jurisdiction over such lawsuit is not barred by the political question doctrine. The U.S. Court of Appeals for the Fifth Circuit reached a similar conclusion in another nuisance lawsuit involving climate change. Based on these recent decisions, this type of litigation may increase in frequency.

There is no guarantee that we will be allowed to fully recover costs incurred to comply with any future legislation, regulation or order that requires a reduction in greenhouse gas emissions or that cost recovery will not be delayed or otherwise conditioned. Any cap-and-trade program that may be adopted, either at the federal, state or regional level, or other legislation, regulation or order designed to reduce greenhouse gas emissions could make some of our electric generating units uneconomic to maintain and could have a material adverse impact on our electric generation and natural gas distribution operations, cash flows and financial condition if such costs are not recovered through regulated rates.

We continue to monitor the legislative, regulatory and legal developments in this area. Although we expect the regulation of greenhouse gas emissions to have a material impact on our operations and rates, we believe it is

premature to attempt to quantify the possible costs of the impacts.

***Our business is dependent on our ability to successfully access capital markets.***

We rely on access to short-term and long-term capital markets to support our capital expenditures and other capital requirements, including expenditures for our utility infrastructure and to comply with future regulatory requirements.

We have historically secured funds from a variety of sources, including the issuance of short-term and long-term debt securities, preferred stock and common stock. Successful implementation of our long-term business strategies is dependent upon our ability to access the capital markets, including the banking and commercial paper markets, under competitive terms and rates. If our access to any of these markets were limited, or our cost of capital significantly increased due to a rating downgrade, prevailing market conditions, failures of financial institutions or other factors, our results of operations and financial condition could be materially and adversely affected.

Acts of terrorism could materially and adversely affect our financial condition and results of operations.

Our electric generation and gas transportation facilities, including the facilities of third parties on which we rely, could be targets of terrorist activities, including cyber terrorism. A terrorist attack on our facilities (or those of third parties) could result in a full or partial disruption of our ability to generate, transmit, transport, purchase or distribute electricity or natural gas or cause environmental repercussions. Any operational disruption or environmental repercussions could result in a significant decrease in our revenues or significant reconstruction or remediation costs, which could materially and adversely affect our results of operations and financial condition.

Energy sales are impacted by seasonal factors and varying weather conditions from year-to-year.

Our electric and gas utility businesses are generally seasonal businesses. Demand for electricity is greater in the summer and winter months associated with cooling and heating. In addition, demand for natural gas peaks in the winter heating season. As a result, our overall results in the future may fluctuate substantially on a seasonal basis. In addition, we have historically had lower revenues and net income when weather conditions are milder. Our rates in Wisconsin are set by the PSCW based on estimated temperatures which approximate 20-year averages. Mild temperatures during the summer cooling season and during the winter heating season will negatively impact the results of operations and cash flows of our electric utility business. In addition, mild temperatures during the winter heating season negatively impact the results of operations and cash flows of our gas utility business.

An increase in natural gas costs could negatively impact our electric and gas utility operations.

Wisconsin Electric burns natural gas in several of its peaking power plants and in PWGS 1 and PWGS 2, and as a supplemental fuel at several coal-fired plants. In many instances the cost of purchased power is tied to the cost of natural gas. In addition, higher natural gas costs also can have the effect of increasing demand for other sources of fuel thereby increasing the costs of those fuels as well. For Wisconsin customers, Wisconsin Electric bears the regulatory risk for the recovery of fuel and purchased power costs when those costs are higher than the forecast of fuel and purchased power costs used to determine the base rate established in its rate structure. Our gas distribution business receives dollar for dollar recovery of the cost of natural gas, subject to tolerance bands and prudence review. However, increased natural gas costs increase the risk that customers will switch to alternative sources of fuel or reduce their usage, which could reduce future gas margins. In addition, an increase in natural gas costs combined with slower economic conditions could also expose us to greater risks of accounts receivable write-offs as more customers are unable to pay their bills. Additionally, high natural gas costs increase our working capital requirements.

We may not be able to obtain an adequate supply of coal, which could limit our ability to operate our coal-fired facilities.

We are dependent on coal for much of our electric generating capacity. Although we currently have an adequate supply of coal at our coal-fired facilities, there can be no assurance that we will continue to have an adequate supply of coal in the future. While we have coal supply and transportation contracts in place, there can be no assurance that the counterparties to these agreements will be able to fulfill their obligations to supply coal to us. The suppliers under these agreements may experience financial or operational problems that inhibit their ability to fulfill their obligations to us. In addition, suppliers under these agreements may not be required to supply coal to us under certain circumstances, such as in the event of a natural disaster. If we significantly reduce our inventory of coal and



are unable to obtain our coal requirements under our coal supply and transportation contracts, we may be required to purchase coal at higher prices, or we may be forced to reduce generation at our coal units and replace this lost generation from higher cost generating resources or through additional power purchases in the MISO Energy Markets.

Our financial performance may be adversely affected if we are unable to successfully operate our facilities.

Our financial performance depends on the successful operation of our electric generating and gas distribution facilities. Operation of these facilities involves many risks, including: operator error and breakdown or failure of equipment processes; fuel supply interruptions; labor disputes; operating limitations that may be imposed by environmental or other regulatory requirements; or catastrophic events such as fires, earthquakes, explosions, floods or other similar occurrences. Unplanned outages can result in additional maintenance expenses as well as incremental replacement power costs.

Poor investment performance of pension plan holdings and other factors impacting pension plan costs could unfavorably impact our liquidity and results of operations.

Our cost of providing defined benefit pension plans is dependent upon a number of factors including actual plan experience and assumptions concerning the future, such as earnings on plan assets, discount rates, the level of interest rates used to measure the required minimum funding levels of the plans, future government regulation and our required or voluntary contributions to be made to the plans. Changes made to the plans may also impact current and future pension costs. Depending upon the growth rate of the pension investments over time and other factors impacting our costs as listed above, we may be required to contribute significant additional amounts in the future to fund our plans. These additional funding obligations could have a material adverse impact on our cash flows, financial condition or results of operations.

We are exposed to risks related to general economic conditions in our service territories.

Our electric and gas utility businesses are impacted by the economic cycles of the customers we serve. As a result of the significant downturn in the economy during 2008 and 2009, we saw a deterioration in regional economic conditions. As the demand for products produced in our service area declines, we ordinarily experience reduced demand for electricity and/or natural gas. If the economic conditions in our service territories and/or demand for products produced in our service area does not continue to improve or declines again, we could experience a further reduction in demand for electricity and/or natural gas that could result in decreased earnings and cash flow. We would also expect our collections of accounts receivable to be adversely impacted.

Customer growth in our service areas affects our results of operations.

Our results of operations are affected by customer growth in our service areas. Customer growth can be affected by population growth as well as economic factors in Wisconsin and the Upper Peninsula of Michigan, including job and income growth. Customer growth directly influences the demand for electricity and gas, and the need for additional power generation and generating facilities. Population declines and/or business closings in our service territories or slower than anticipated customer growth as a result of the significant downturn in the economy during 2008 and 2009 or otherwise has, to a limited extent, and could continue to have, a material adverse impact on our cash flow, financial condition or results of operations.

We are a holding company and are subject to restrictions on our ability to pay dividends.

Wisconsin Energy is a holding company and has no significant operations of its own. Accordingly, our ability to meet our financial obligations and pay dividends on our common stock is dependent upon the ability of our subsidiaries to pay amounts to us, whether through dividends or other payments. The ability of our subsidiaries to pay amounts to us will depend on the earnings, cash flows, capital requirements and general financial condition of our subsidiaries and on regulatory limitations. Prior to distributing cash to Wisconsin Energy, our subsidiaries have financial obligations that must be satisfied, including among others, debt service and preferred stock dividends. Our subsidiaries also have dividend payment restrictions based on the terms of their outstanding preferred stock and regulatory limitations applicable to them. In addition, each of the bank back-up credit facilities for Wisconsin Energy, Wisconsin Electric and Wisconsin Gas have specified total funded debt to capitalization ratios that must be maintained.

Provisions of the Wisconsin Utility Holding Company Act limit our ability to invest in non-utility businesses and could deter takeover attempts by a potential purchaser of our common stock that would be willing to pay a premium for our common stock.

Under the Wisconsin Utility Holding Company Act, we remain subject to certain restrictions that have the potential of limiting our diversification into non-utility businesses. Under the Act, the sum of certain assets of all non-utility affiliates in a holding company system may not exceed 25% of the assets of all public utility affiliates in the system.

In addition, the Act precludes the acquisition of 10% or more of the voting shares of a holding company of a Wisconsin public utility unless the PSCW has first determined that the acquisition is in the best interests of utility customers, investors and the public. This provision and other requirements of the Act may delay or reduce the likelihood of a sale or change of control of Wisconsin Energy. As a result, shareholders may be deprived of opportunities to sell some or all of their shares of our common stock at prices that represent a premium over market prices.

Governmental agencies could modify our permits, authorizations or licenses.

Wisconsin Electric, Wisconsin Gas and Edison Sault are required to comply with the terms of various permits, authorizations and licenses. These permits, authorizations and licenses may be revoked or modified by the agencies that granted them if facts develop that differ significantly from the facts assumed when they were issued. In addition, discharge permits and other approvals and licenses are often granted for a term that is less than the expected life of the associated facility. Licenses and permits may require periodic renewal, which may result in additional requirements being imposed by the granting agency.

Also, if we are unable to obtain, renew or comply with these governmental permits, authorizations or licenses, or if we are unable to recover any increased costs of complying with additional license requirements or any other associated costs in our rates in a timely manner, our results of operations and financial condition could be materially and adversely affected.

Restructuring in the regulated energy industry could have a negative impact on our business.

The regulated energy industry continues to experience significant structural changes. Increased competition in the retail and wholesale markets, which may result from restructuring efforts, could have a significant adverse financial

impact on us. It is uncertain when retail access might be implemented in Wisconsin; however, Michigan has adopted retail choice which potentially affects our Michigan operations. Under retail access legislation, customers are permitted to choose their own electric generation supplier. All Michigan electric customers were able to choose their electric generation supplier beginning in January 2002. Although competition and customer switching to alternative suppliers in our service territories in Michigan has been limited, the additional competitive pressures resulting from retail access could lead to a loss of customers and our incurring stranded costs.

FERC continues to support the existing RTOs that affect the structure of the wholesale market within those RTOs. In connection with its status as a FERC approved RTO, MISO implemented the bid-based energy markets that are part of the MISO Energy Markets on April 1, 2005. The MISO Energy Markets rules require that all market participants submit day-ahead and/or real-time bids and offers for energy at locations across the MISO region. MISO then calculates the most efficient solution for all of the bids and offers made into the market that day and establishes a LMP that reflects the market price for energy. As a participant in the MISO Energy Markets

, we are required to follow MISO's instructions when dispatching generating units to support MISO's responsibility for maintaining stability of the transmission system. In addition, in January 2009, MISO implemented an Ancillary Services Market for operating reserves that was simultaneously co-optimized with MISO's existing energy markets.

The new market designs have the potential to increase the costs of transmission, the costs associated with inefficient generation dispatching, the costs of participation in the market and the costs associated with estimated payment settlements.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

We own our principal properties outright, except that the major portion of our electric utility distribution lines, steam utility distribution mains and gas utility distribution mains and services are located, for the most part, on or under streets and highways and on land owned by others and are generally subject to granted easements, consents or permits.

As of December 31, 2009, we owned the following generating stations:

| Name              | Fuel | No. of<br>Generating<br>Units | Dependable<br>Capability<br>In MW (a) |
|-------------------|------|-------------------------------|---------------------------------------|
| Coal-Fired Plants |      |                               |                                       |
| Oak Creek (b)     | Coal | 4                             | 1,139                                 |
| Presque Isle      | Coal | 5                             | 431                                   |

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|  |         |     |       |
|--|---------|-----|-------|
| Pleasant Prairie                       | Coal    | 2   | 1,218 |
| Valley                                 | Coal    | 2   | 227   |
| Edgewater 5 (c)                        | Coal    | 1   | 105   |
| Milwaukee County                       | Coal    | 3   | 11    |
| Total Coal-Fired Plants                |         | 17  | 3,131 |
| Hydro Plants (14 in number)            |         | 107 | 84    |
| Port Washington Generating Station (d) | Gas     | 2   | 1,090 |
| Germantown Combustion Turbines         | Gas/Oil | 5   | 345   |
| Concord Combustion Turbines            | Gas/Oil | 4   | 400   |
| Paris Combustion Turbines              | Gas/Oil | 4   | 400   |
| Byron Wind Turbines (e)                | Wind    | 2   | -     |
| Blue Sky Green Field (f)               | Wind    | 88  | 29    |
| Other Combustion Turbines & Diesel     | Gas/Oil | 4   | 10    |
| Total System                           |         | 233 | 5,489 |

- (a) Dependable capability is the net power output under average operating conditions with equipment in an average state of repair as of a given month in a given year. We are a summer peaking electric utility. The values are established by tests and may change slightly from year to year.
- (b) OC 1 was placed into service on February 2, 2010. Bechtel is targeting the commercial operation of OC 2 by the end of August 2010. Our share of the dependable capability of these units is estimated to be 1,030 MW.
- (c) We have a 25% interest in Edgewater Generating Unit 5, which is operated by WPL, an unaffiliated utility. During the fourth quarter of 2009, we reached a contingent agreement with WPL to sell our interest in this unit. We are continuing to negotiate with a third party to sell our interest in this unit. Any sale will be subject to PSCW approval.
- (d) Effective July 2005 and May 2008, Wisconsin Electric began leasing PWGS 1 and PWGS 2, respectively, from We Power under 25 year leases. Both units are natural gas-fired generation units with 545 MW each of dependable capability.
- (e) The Byron Wind Turbines are able to generate up to 1.2 MW of electricity; however, due to the intermittent characteristics of wind power, their dependable capability is less than 1 MW.
- (f) Blue Sky Green Field is able to generate up to approximately 145 MW of electricity; however, due to the intermittent characteristics of wind power, its dependable capability is approximately 29 MW.

As of December 31, 2009, we operated approximately 22,809 pole-miles of overhead distribution lines and 23,778 miles of underground distribution cable, as well as approximately 337 distribution substations and 284,974 line transformers.

As of December 31, 2009, our gas distribution system included approximately 20,204 miles of distribution and transmission mains connected at 184 gate stations to the pipeline transmission systems of ANR Pipeline Company, Guardian, Natural Gas Pipeline Company of America, Northern Natural Pipeline Company, Great Lakes Transmission Company, Viking Gas Transmission and Michigan Consolidated Gas Company. We have liquefied natural gas storage plants which convert and store, in liquefied form, natural gas received during periods of low consumption. The liquefied natural gas storage plants have a send-out capability of 73,600 Dth per day. We also have propane air systems for peaking purposes. These propane air systems will provide approximately 2,400 Dth per day of supply to the system. Our gas distribution system consists almost entirely of plastic and coated steel pipe.

We also own office buildings, gas regulating and metering stations and major service centers, including garage and warehouse facilities, in certain communities we serve. Where distribution lines and services and gas distribution mains and services occupy private property, we have in some, but not all instances, obtained consents, permits or easements for these installations from the apparent owners or those in possession of those properties, generally without an examination of ownership records or title.

As of December 31, 2009, the combined steam systems supplied by the Valley and Milwaukee County Power Plants consisted of approximately 43 miles of both high pressure and low pressure steam piping, nine miles of walkable tunnels and other pressure regulating equipment.

We Power:

We Power completed construction of PWGS 1 and PWGS 2, both natural gas units with a dependable capability of 545 MW each, in July 2005 and May 2008, respectively. We Power also completed construction of OC 1, a 615 MW coal plant (of which we own approximately 515 MW), on February 2, 2010. We Power is still in the process of constructing OC 2, another 615 MW coal plant of which we will also own approximately 515 MW. For information about PTF, see Factors Affecting Results, Liquidity and Capital Resources -- Power the Future in Item 7.

### ITEM 3. LEGAL PROCEEDINGS

In addition to those legal proceedings discussed below, we are currently, and from time to time, subject to claims and suits arising in the ordinary course of business. Although the results of these other legal proceedings cannot be predicted with certainty, management believes, after consultation with legal counsel, that the ultimate resolution of these proceedings will not have a material adverse effect on our financial statements.

### ENVIRONMENTAL MATTERS

We are subject to federal, state and certain local laws and regulations governing the environmental aspects of our operations. Management believes that our existing facilities are in material compliance with applicable environmental requirements.

Solvay Coke and Gas Site:

Wisconsin Electric and Wisconsin Gas have been identified as potentially responsible parties at the Solvay Coke and Gas Site located in Milwaukee, Wisconsin. A predecessor company of Wisconsin Electric owned a parcel of property that is within the property boundaries of the site. A predecessor company of Wisconsin Gas had a customer and corporate relationship with the entity that owned and operated the site. In 2007, Wisconsin Electric, Wisconsin Gas and several other parties entered into an Administrative Settlement Agreement and Order with the EPA to perform additional investigation and assessment and reimburse the EPA's oversight costs. Under the Administrative Settlement Agreement, neither Wisconsin Electric nor Wisconsin Gas admits to any liability for the site, waives any liability defenses, or commits to perform future site remedial activities at this time. The companies' share of the costs to perform the required work and reimburse the EPA's oversight costs, as well as potential future remediation cost estimates and reserves, are included in the estimated manufactured gas plant values reported in Note S -- Commitments and Contingencies in the Notes to Consolidated Financial Statements in Item 8.

#### Edgewater Generating Unit 5

: In December 2009, the EPA issued a NOV concerning several coal-fired power plants owned and operated by WPL, including Edgewater Generating Unit 5, of which Wisconsin Electric owns 25%. Due to that ownership interest, Wisconsin Electric was named in the NOV. The NOV alleges that certain maintenance projects at WPL's units, including Edgewater 5, were undertaken without obtaining air permits required by the CAA. Wisconsin Electric is working with WPL, who is the primary owner and operator of the plants, and the

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co-owners of the other plants identified in the NOV, to respond to the NOV. At this time, we cannot predict the outcome of this matter. Also in December 2009, the Sierra Club submitted to WPL a notice of intent to file a citizen suit under the CAA. This notice of intent alleged violations of air permitting and opacity requirements at the Edgewater Generating Station.

See Environmental Compliance in Item 1 and Environmental Matters, Manufactured Gas Plant Sites, Ash Landfill Sites and EPA - Consent Decree in Note S -- Commitments and Contingencies in the Notes to Consolidated Financial Statements which are incorporated by reference herein, for a discussion of matters related to certain solid waste and coal-ash landfills, manufactured gas plant sites and air quality.

#### UTILITY RATE MATTERS

See Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters in Item 7 for information concerning rate matters in the jurisdictions where Wisconsin Electric, Wisconsin Gas and Edison Sault do business.

#### OTHER MATTERS

##### Used Nuclear Fuel Storage and Removal:

See Factors Affecting Results, Liquidity and Capital Resources -- Nuclear Operations in Item 7 for information concerning the DOE's breach of contract with Wisconsin Electric that required the DOE to begin permanently

removing used nuclear fuel from Point Beach by January 31, 1998.

#### Stray Voltage:

In recent years, several actions by dairy farmers have been commenced or claims made against Wisconsin Electric for loss of milk production and other damages to livestock allegedly caused by stray voltage resulting from the operation of its electrical system. For additional information, see Factors Affecting Results, Liquidity and Capital Resources -- Legal Matters in Item 7.

For information regarding additional legal matters, see Factors Affecting Results, Liquidity and Capital Resources -- Legal Matters in Item 7. For information concerning our PTF strategy, including the Settlement Agreement with Bechtel, see Factors Affecting Results, Liquidity and Capital Resources -- Power the Future.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the fourth quarter of 2009.

#### EXECUTIVE OFFICERS OF THE REGISTRANT

The names, ages at December 31, 2009 and positions of our executive officers are listed below along with their business experience during the past five years. All officers are appointed until they resign, die or are removed pursuant to the Bylaws. There are no family relationships among these officers, nor is there any agreement or understanding between any officer and any other person pursuant to which the officer was selected.

Gale E. Klappa.

Age 59.

- Wisconsin Energy -- Chairman of the Board and Chief Executive Officer since May 2004. President since April 2003.
- Wisconsin Electric -- Chairman of the Board since May 2004. President and Chief Executive Officer since August 2003.
- Wisconsin Gas -- Chairman of the Board since May 2004. President and Chief Executive Officer since August 2003.
- Director of Joy Global, Inc. and Badger Meter, Inc.
- Director of Wisconsin Energy, Wisconsin Electric and Wisconsin Gas since 2003.

Charles R. Cole.

Age 63.

- Wisconsin Electric -- Senior Vice President since 2001.
- Wisconsin Gas -- Senior Vice President since July 2004.

Stephen P. Dickson.

Age 49.

- Wisconsin Energy -- Vice President since 2005. Controller since 2000.
- Wisconsin Electric -- Vice President since 2005. Controller since 2000.
- Wisconsin Gas -- Vice President since 2005. Controller since 1998.

James C. Fleming.

Age 64.

- Wisconsin Energy -- General Counsel since March 2006. Executive Vice President since January 2006.
- Wisconsin Electric -- General Counsel since March 2006. Executive Vice President since January 2006.
- Wisconsin Gas -- General Counsel since March 2006. Executive Vice President since January 2006.
- Southern Company Services, Inc. -- Vice President and Associate General Counsel from 1998 to December 2005. Southern Company Services is an affiliate of The Southern Company, a public utility holding company serving the southeastern United States.

Frederick D. Kuester.

Age 59.

- Wisconsin Energy -- Executive Vice President since May 2004.
- Wisconsin Electric -- Executive Vice President since May 2004. Chief Operating Officer since October 2003.
- Wisconsin Gas -- Executive Vice President since May 2004.

Mirant Corporation, of which Mr. Kuester was Senior Vice President - International from 2001 to October 2003 and Chief Executive Officer of Mirant Asia - Pacific Limited from 1999 to October 2003, and certain of its subsidiaries voluntarily filed for bankruptcy in July 2003. Other than certain Canadian subsidiaries, none of Mirant's international subsidiaries filed for bankruptcy.

Allen L. Leverett.

Age 43.

- Wisconsin Energy -- Executive Vice President since May 2004. Chief Financial Officer since July 2003.
- Wisconsin Electric -- Executive Vice President since May 2004. Chief Financial Officer since July 2003.
- Wisconsin Gas -- Executive Vice President since May 2004. Chief Financial Officer since July 2003.

Kristine A. Rappé.

Age 53.

- Wisconsin Energy -- Senior Vice President and Chief Administrative Officer since May 2004.
- Wisconsin Electric -- Senior Vice President and Chief Administrative Officer since May 2004.
- Wisconsin Gas -- Senior Vice President and Chief Administrative Officer since May 2004.

Certain executive officers also hold offices in our non-utility subsidiaries.



PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER  
MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES  
NUMBER OF COMMON STOCKHOLDERS

As of December 31, 2009, based upon the number of Wisconsin Energy Corporation stockholder accounts (including accounts in our dividend reinvestment and stock purchase plan), we had approximately 45,500 registered stockholders.

## COMMON STOCK LISTING AND TRADING

Our common stock is listed on the New York Stock Exchange under the ticker symbol "WEC." Daily trading prices and volume can be found in the "NYSE Composite" section of most major newspapers, usually abbreviated as WI Engy.

## DIVIDENDS AND COMMON STOCK PRICES

## Common Stock Dividends of Wisconsin Energy:

Cash dividends on our common stock, as declared by the Board of Directors, are normally paid on or about the first day of March, June, September and December of each year. We review our dividend policy on a regular basis. Subject to any regulatory restrictions or other limitations on the payment of dividends, future dividends will be at the discretion of the Board of Directors and will depend upon, among other factors, earnings, financial condition and other requirements. For information regarding restrictions on the ability of our subsidiaries to pay us dividends, see Note J -- Common Equity in the Notes to Consolidated Financial Statements in Item 8.

Our current dividend policy is to target a dividend payout ratio between 40% and 45% of expected earnings for the years 2010 and 2011. Beginning in 2012, we plan to target a dividend payout ratio of 45% to 50% of expected earnings. In January 2010, our Board of Directors increased our quarterly dividend to \$0.40 per share, which would result in annual dividends of \$1.60 per share.

## Range of Wisconsin Energy Common Stock Prices and Dividends:

| Quarter | 2009    |         |          | 2008    |         |          |
|---------|---------|---------|----------|---------|---------|----------|
|         | High    | Low     | Dividend | High    | Low     | Dividend |
| First   | \$46.48 | \$36.31 | \$0.3375 | \$49.61 | \$42.00 | \$0.27   |
| Second  | \$42.23 | \$36.67 | 0.3375   | \$48.75 | \$44.22 | 0.27     |

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|        |         |         |                      |         |         |                      |
|--------|---------|---------|----------------------|---------|---------|----------------------|
| Third  | \$46.50 | \$40.25 | 0.3375               | \$47.24 | \$42.01 | 0.27                 |
| Fourth | \$50.62 | \$42.89 | <u>0.3375</u>        | \$46.10 | \$34.89 | <u>0.27</u>          |
| Annual | \$50.62 | \$36.31 | <u><u>\$1.35</u></u> | \$49.61 | \$34.89 | <u><u>\$1.08</u></u> |

ISSUER PURCHASES OF EQUITY SECURITIES

| 2009                       | Total Number of Shares Purchased (a) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------------------|--------------------------------------|------------------------------|--|--|
|                            |                                      |                              |  | (Millions of Dollars)  |
| October 1-<br>October 31   | 1,278                                | \$44.26                      | -  | \$ -   |
| November 1-<br>November 30 | 1,392                                | \$45.51                      | -  | \$ -   |
| December 1-<br>December 31 | -                                    | \$ -                         | -  | \$ -   |
| Total                      | <u><u>2,670</u></u>                  | \$44.91                      | <u><u>-</u></u>  | \$ -   |

- (a) All shares reported during the quarter were surrendered by employees to satisfy tax withholding obligations upon vesting of restricted stock.

ITEM 6.  
SELECTED  
FINANCIAL  
DATA

WISCONSIN ENERGY CORPORATION  
CONSOLIDATED SELECTED FINANCIAL AND STATISTICAL DATA

| <u>Financial</u>          | <u>2009</u> | <u>2008</u> | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|---------------------------|-------------|-------------|-------------|-------------|-------------|
| Year Ended<br>December 31 |             |             |             |             |             |

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|   |    |          |    |          |    |          |    |          |    |          |
|---|----|----------|----|----------|----|----------|----|----------|----|----------|
| Net income -<br>Continuing<br>Operations<br>(Millions)  | \$ | 377.2    | \$ | 357.8    | \$ | 335.7    | \$ | 311.8    | \$ | 303.0    |
| Earnings per<br>share -<br>Continuing<br>Operations   |    |          |    |          |    |          |    |          |    |          |
| Basic   | \$ | 3.23     | \$ | 3.06     | \$ | 2.87     | \$ | 2.66     | \$ | 2.59     |
| Diluted   | \$ | 3.20     | \$ | 3.03     | \$ | 2.83     | \$ | 2.63     | \$ | 2.56     |
| Dividends per<br>share of<br>common stock   | \$ | 1.35     | \$ | 1.08     | \$ | 1.00     | \$ | 0.92     | \$ | 0.88     |
| Operating<br>revenues<br>(Millions)   |    |          |    |          |    |          |    |          |    |          |
| Utility<br>energy   | \$ | 4,119.3  | \$ | 4,421.3  | \$ | 4,222.1  | \$ | 3,976.5  | \$ | 3,790.7  |
| Non-utility<br>energy   |    | 163.1    |    | 126.2    |    | 75.7     |    | 69.1     |    | 40.0     |
| Eliminations<br>and Other   |    | (154.5)  |    | (119.7)  |    | (62.7)   |    | (51.7)   |    | (17.5)   |
| Total operating<br>revenues   | \$ | 4,127.9  | \$ | 4,427.8  | \$ | 4,235.1  | \$ | 3,993.9  | \$ | 3,813.2  |
| As of December<br>31 (Millions)   |    |          |    |          |    |          |    |          |    |          |
| Total assets  | \$ | 12,697.9 | \$ | 12,617.8 | \$ | 11,720.3 | \$ | 11,130.2 | \$ | 10,462.0 |
| Long-term<br>debt (including<br>current<br>maturities) and<br>capital<br>lease<br>obligations | \$ | 4,171.5  | \$ | 4,136.5  | \$ | 3,525.3  | \$ | 3,370.1  | \$ | 3,527.0  |
| Common<br>Stock Closing<br>Price  | \$ | 49.83    | \$ | 41.98    | \$ | 48.71    | \$ | 47.46    | \$ | 39.06    |

CONSOLIDATED SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

(Millions of Dollars, Except Per Share Amounts) (a)

|                                     | March |      | June |      |
|-------------------------------------|-------|------|------|------|
|                                     | 2009  | 2008 | 2009 | 2008 |
| <u>Three Months</u><br><u>Ended</u> |       |      |      |      |

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|  |                    |                    |                    |                    |
|--|--------------------|--------------------|--------------------|--------------------|
| Operating revenues                               | \$ 1,396.2         | \$ 1,431.1         | \$ 842.5           | \$ 945.4           |
| Operating income                                 | 243.0              | 217.5              | 119.2              | 107.9              |
| Income from Continuing Operations                | 141.5              | 123.0              | 63.4               | 58.2               |
| Income (loss) from Discontinued Operations       | -                  | 0.2                | 0.3                | (0.2)              |
| <b>Total Net Income</b>                          | <b>\$ 141.5</b>    | <b>\$ 123.2</b>    | <b>\$ 63.7</b>     | <b>\$ 58.0</b>     |
| Earnings per share of common stock (basic) (b)   |                    |                    |                    |                    |
| Continuing operations                            | \$ 1.21            | \$ 1.05            | \$ 0.54            | \$ 0.50            |
| Discontinued operations                          | -                  | -                  | -                  | -                  |
| <b>Total earnings per share (basic)</b>          | <b>\$ 1.21</b>     | <b>\$ 1.05</b>     | <b>\$ 0.54</b>     | <b>\$ 0.50</b>     |
| Earnings per share of common stock (diluted) (b) |                    |                    |                    |                    |
| Continuing operations                            | \$ 1.20            | \$ 1.04            | \$ 0.54            | \$ 0.49            |
| Discontinued operations                          | -                  | -                  | -                  | -                  |
| <b>Total earnings per share (diluted)</b>        | <b>\$ 1.20</b>     | <b>\$ 1.04</b>     | <b>\$ 0.54</b>     | <b>\$ 0.49</b>     |
|  | <b>September</b>   |                    | <b>December</b>    |                    |
| <b>Three Months Ended</b>                        | <b><u>2009</u></b> | <b><u>2008</u></b> | <b><u>2009</u></b> | <b><u>2008</u></b> |
| Operating revenues                               | \$ 821.9           | \$ 851.5           | \$ 1,067.3         | \$ 1,199.8         |
| Operating income                                 | 104.9              | 138.4              | 196.6              | 195.4              |

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|  |                |                |                 |                 |
|--|----------------|----------------|-----------------|-----------------|
| Income from Continuing Operations                | 58.7           | 76.6           | 113.6           | 100.0           |
| Income (loss) from Discontinued Operations       | (0.2)          | 0.9            | 5.1             | 0.4             |
| Total Net Income                                 | <u>\$ 58.5</u> | <u>\$ 77.5</u> | <u>\$ 118.7</u> | <u>\$ 100.4</u> |
| Earnings per share of common stock (basic) (b)   |                |                |                 |                 |
| Continuing operations                            | \$ 0.50        | \$ 0.65        | \$ 0.97         | \$ 0.86         |
| Discontinued operations                          | -              | 0.01           | 0.04            | -               |
| Total earnings per share (basic)                 | <u>\$ 0.50</u> | <u>\$ 0.66</u> | <u>\$ 1.01</u>  | <u>\$ 0.86</u>  |
| Earnings per share of common stock (diluted) (b) |                |                |                 |                 |
| Continuing operations                            | \$ 0.50        | \$ 0.64        | \$ 0.96         | \$ 0.85         |
| Discontinued operations                          | -              | 0.01           | 0.04            | -               |
| Total earnings per share (diluted)               | <u>\$ 0.50</u> | <u>\$ 0.65</u> | <u>\$ 1.00</u>  | <u>\$ 0.85</u>  |

- (a) Quarterly results of operations are not directly comparable because of seasonal and other factors. See Management's Discussion and Analysis of Financial Condition and Results of Operations.
- (b) Quarterly earnings per share may not total to the amounts reported for the year because the computation is based on the

weighted  
average  
common  
shares  
outstanding  
during each  
quarter.

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

### CORPORATE DEVELOPMENTS

#### INTRODUCTION

Wisconsin Energy Corporation is a diversified holding company with subsidiaries primarily in a utility energy segment and a non-utility energy segment. Unless qualified by their context, when used in this document the terms Wisconsin Energy, the Company, our, us or we refer to the holding company and all of its subsidiaries.

Our utility energy segment, primarily consists of Wisconsin Electric and Wisconsin Gas, both doing business under the trade name of "We Energies". We generate and distribute electricity in Wisconsin and the Upper Peninsula of Michigan and we distribute natural gas in Wisconsin. Our non-utility energy segment primarily consists of We Power. We Power is principally engaged in the engineering, construction and development of electric power generating facilities for long-term lease to Wisconsin Electric under our PTF strategy.

#### CORPORATE STRATEGY

##### Business Opportunities

We seek to increase shareholder value by leveraging on our core competencies. Our key corporate strategy, announced in September 2000, is PTF. This strategy is designed to address Wisconsin's growing electric supply needs by increasing the electric generating capacity in the state while maintaining a fuel-diverse, reasonably priced electric supply. It is also designed to improve the delivery of energy within our distribution systems to meet increasing customer demands and to support our commitment to improved environmental performance. PWGS 1 and PWGS 2, two 545 MW natural gas electric generating units, were placed in service in July 2005 and May 2008, respectively, and OC 1, a 615 MW coal-fired generating unit, was placed in service on February 2, 2010. Although the new guaranteed in-service date is November 28, 2010, our contractor, Bechtel, is currently targeting commercial operation

of OC 2, another 615 MW coal-fired generating unit, by the end of August 2010.

We have an undivided ownership interest in 515 MW of each of OC 1 and OC 2. We sold an approximately 17%, or 100 MW, ownership interest in each of OC 1 and OC 2 to two co-owners.

#### Utility Energy Segment:

Our utility energy segment strives to provide reasonably priced energy delivered at high levels of customer service and reliability. We expect our prices to continue to be established by our regulatory bodies under traditional rate base, cost of service methodologies. We continue to gain efficiencies and improve the effectiveness of our service deliveries through the combined support operations of our electric and gas businesses. We work to obtain a reliable, reasonably-priced supply of electricity through plants that we operate and various long-term supply contracts.

#### Non-Utility Energy Segment:

Our primary focus in this segment is to improve the supply of electric generation in Wisconsin. We Power was formed to design, construct, own and lease to Wisconsin Electric new generation assets under our PTF strategy.

#### Power the Future Strategy:

In February 2001, we filed a petition with the PSCW that would allow us to begin implementing our 10-year PTF strategy to improve the supply and reliability of electricity in Wisconsin. PTF is intended to meet the demand for electricity and ensure a diverse fuel mix while keeping electricity prices reasonable. Under PTF, we are (1) investing approximately \$2.7 billion in 2,120 MW of new natural gas-fired and coal-fired generating capacity at existing sites; (2) upgrading our existing electric generating facilities; and (3) investing in upgrades of our existing energy distribution system.

In November 2001, we created We Power to design, construct, own and lease the new generating capacity. Wisconsin Electric will lease each new generating facility from We Power as well as operate and maintain the new plants under 25- to 30-year lease agreements approved by the PSCW. Based upon the structure of the leases, we expect to recover the investments in We Power's new facilities over the initial lease term. At the end of the leases,

Wisconsin Electric will have the right to acquire the plants outright at market value or to renew the leases. Wisconsin Electric expects that payments under the plant leases will be recoverable in rates under the provisions of the Wisconsin Leased Generation Law.

We expect a significant portion of our future generation needs will be met through We Power's construction of the PWGS units and the Oak Creek expansion.

We have financed the construction of the PTF units with internally generated cash, asset sales and short-term borrowings. When the plants are placed into service, we issue long-term debt and use the net proceeds to repay the short-term borrowings. We currently do not plan to issue any new common equity as part of our PTF strategy.

The primary risks that remain under PTF are construction risks associated with the schedule and costs for OC 2; changes in applicable laws or regulations; adverse interpretation or enforcement of permit conditions, laws or regulations by the permitting agencies; the ability to obtain necessary operating permits in a timely manner; obtaining the investment capital from outside sources necessary to implement the strategy; governmental actions; and events in the global economy.

For further information concerning PTF capital requirements, see Liquidity and Capital Resources below. For additional information regarding risks associated with our PTF strategy, see Factors Affecting Results, Liquidity and Capital Resources below.

## Sale of Point Beach:

In September 2007, Wisconsin Electric sold Point Beach to an affiliate of FPL for approximately \$924 million. Pursuant to the terms of the sale agreement, the buyer purchased Point Beach, its nuclear fuel and associated inventories and assumed the obligation to decommission the plant. Wisconsin Electric retained approximately \$506 million of the sales proceeds, which represents the net book value of the assets sold and certain transaction costs. Wisconsin Electric deferred the net gain on the sale of approximately \$418 million as a regulatory liability and deposited those proceeds into a restricted cash account. In connection with the sale, Wisconsin Electric also transferred \$390 million of decommissioning funds to the buyer. Wisconsin Electric then liquidated the balance of the decommissioning trust assets and retained approximately \$552 million, which was also placed into the restricted cash account. At the direction of our regulators, we are using the cash in the restricted cash account and the interest earned on the balance for the benefit of our customers and to pay certain taxes related to the liquidation of the qualified decommissioning trust. For further information on the 2008 and 2010 rate cases, see Utility Rates and Regulatory Matters under Factors Affecting Results, Liquidity and Capital Resources in this report.

A long-term power purchase agreement with the buyer became effective upon closing of the sale. Pursuant to this agreement, Wisconsin Electric is purchasing all of the energy produced by Point Beach. The power purchase agreement extends through 2030 for Unit 1 and 2033 for Unit 2. Based on the agreement, we are paying a pre-determined price per MWh for energy delivered.

## Divestiture of Assets

Our PTF strategy led to a decision to divest non-core businesses. These non-core businesses primarily included non-utility generation assets located outside of Wisconsin, a substantial amount of Wispark's real estate portfolio and our manufacturing business. In addition, in 2001 we contributed our transmission assets to ATC and received cash proceeds of \$119.8 million and an economic interest in ATC. In 2007, we sold Point Beach for approximately \$924 million. Since 2000, we have received total proceeds of approximately \$3.2 billion from the divestiture of assets.

## RESULTS OF OPERATIONS

## CONSOLIDATED EARNINGS

The following table compares our operating income by business segment and our net income for 2009, 2008 and 2007:

| Wisconsin Energy Corporation                 | 2009                  | 2008    | 2007    |
|--|-----------------------|---------|---------|
|  | (Millions of Dollars) |         |         |
| Utility Energy                               | \$554.3               | \$580.5 | \$584.7 |
| Non-Utility Energy                           | 120.1                 | 89.3    | 47.4    |
| Corporate and Other                          | (10.7)                | (10.6)  | (4.9)   |
| Total Operating Income                       | 663.7                 | 659.2   | 627.2   |
| Equity in Earnings of Transmission Affiliate | 59.1                  | 51.8    | 43.1    |
| Other Income and Deductions, net             | 28.4                  | 17.0    | 48.9    |



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|   |         |         |         |
|---|---------|---------|---------|
| Interest Expense, net                                     | 156.7   | 153.7   | 167.6   |
| Income From Continuing Operations Before<br>Income Taxes  | 594.5   | 574.3   | 551.6   |
| Income Taxes  | 217.3   | 216.5   | 215.9   |
| Income From Continuing Operations                         | 377.2   | 357.8   | 335.7   |
| Income (Loss) From Discontinued Operations,<br>Net of Tax | 5.2     | 1.3     | (0.1)   |
| Net Income  | \$382.4 | \$359.1 | \$335.6 |
| Diluted Earnings Per Share                                |         |         |         |
| Continuing Operation                                      | \$3.20  | \$3.03  | \$2.83  |
| Discontinued Operations                                   | 0.04    | 0.01    | -       |
| Total Diluted Earnings Per Share                          | \$3.24  | \$3.04  | \$2.83  |

An analysis of contributions to operating income by segment and a more detailed analysis of results follow.

UTILITY ENERGY SEGMENT CONTRIBUTION TO OPERATING INCOME

2009 vs. 2008:

Our utility energy segment contributed \$554.3 million of operating income during 2009 compared with \$580.5 million of operating income during 2008. The most significant factors that impacted operating income during 2009 were less favorable weather during the spring and summer months and a decline in economic conditions throughout 2009, both of which decreased electric sales. However, we experienced a decrease in fuel and purchased power costs largely due to lower MWh sales and a decrease in operating and maintenance expense during 2009 as compared to 2008.

2008 vs. 2007:

Our utility energy segment contributed \$580.5 million of operating income during 2008 compared with \$584.7 million of operating income during 2007. During 2008, we experienced less favorable weather in the summer months, which decreased electric sales. In addition, our fuel and purchased power costs increased primarily as a result of the power purchase agreement entered into upon the sale of Point Beach. Finally, our other operating and maintenance expenses were higher due primarily to increased regulatory amortizations allowed in rates. These items were largely offset by our rate increases and increased margin from gas sales due to colder weather.

The following table summarizes our utility energy segment's operating income during 2009, 2008 and 2007:

| Utility Energy Segment | 2009                  | 2008      | 2007      |
|------------------------|-----------------------|-----------|-----------|
|                        | (Millions of Dollars) |           |           |
| Operating Revenues     |                       |           |           |
| Electric               | \$2,712.3             | \$2,686.4 | \$2,705.7 |
| Gas                    | 1,367.9               | 1,694.6   | 1,481.2   |
| Other                  | 39.1                  | 40.3      | 35.2      |

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|  |                       |                       |                       |
|--|-----------------------|-----------------------|-----------------------|
| Total Operating Revenues                           | 4,119.3               | 4,421.3               | 4,222.1               |
| Fuel and Purchased Power                           | 1,068.4               | 1,244.9               | 1,000.6               |
| (a)  |                       |                       |                       |
| Cost of Gas Sold                                   | <u>912.0</u>          | <u>1,220.9</u>        | <u>1,052.3</u>        |
| Gross Margin                                       | 2,138.9               | 1,955.5               | 2,169.2               |
| Other Operating Expenses                           |                       |                       |                       |
| Other Operation and Maintenance                    | 1,387.6               | 1,451.7               | 1,173.5               |
| (a)  |                       |                       |                       |
| Depreciation, Decommissioning and Amortization (a) | 316.2                 | 303.8                 | 314.9                 |
| Property and Revenue Taxes                         | 111.5                 | 107.6                 | 102.6                 |
| Total Operating Expenses                           | <u>3,795.7</u>        | <u>4,328.9</u>        | <u>3,643.9</u>        |
| Amortization of Gain                               | <u>230.7</u>          | <u>488.1</u>          | <u>6.5</u>            |
| Operating Income                                   | <u><u>\$554.3</u></u> | <u><u>\$580.5</u></u> | <u><u>\$584.7</u></u> |

- (a) In September 2007, we sold Point Beach and commenced purchasing power from the new owner under a power purchase agreement. As a result of the sale and the power purchase agreement, our 2009 and 2008 earnings reflect higher fuel and purchased power costs as compared to 2007. In addition, as it relates to nuclear operating costs, our 2009 and 2008 operating income reflects lower other operation and maintenance costs and lower depreciation, decommissioning and amortization costs as we no longer own Point Beach.

In January 2008, Wisconsin Electric received a rate order from the PSCW that authorized a 17.2% increase in electric rates to recover increased costs associated with transmission expenses, our PTF program, environmental expenditures, continued investment in renewable and efficiency programs and recovery of previously deferred regulatory assets. The PSCW allowed us to issue bill credits to our customers from the proceeds of the net gain and excess decommissioning funds associated with the sale of Point Beach to mitigate this increase. The PSCW also determined that \$85.0 million of Point Beach proceeds should be immediately applied during the first quarter of 2008 to offset certain regulatory assets. As a result of these bill credits, we estimate that the January 2008 PSCW rate order resulted in a net 3.2% increase in electric rates paid by our Wisconsin customers in 2008 and resulted in another net increase of 3.2% in 2009. The bill credits that we issue to our customers and the proceeds immediately applied to regulatory assets are reflected on our income statement in the amortization of the gain on the sale of Point Beach. As we issue the bill credits, we transfer the cash from a restricted account to an unrestricted account. The transferred cash is equal to the bill credits, less taxes.

## Electric Utility Gross Margin

The following table compares our electric utility gross margin during 2009 with similar information for 2008 and 2007, including a summary of electric operating revenues and electric sales by customer class:

| Electric Utility Operations    | Electric Revenues and Gross Margin |           |           | MWh Sales                       |          |          |
|--------------------------------|------------------------------------|-----------|-----------|---------------------------------|----------|----------|
|                                | 2009                               | 2008      | 2007      | 2009                            | 2008     | 2007     |
|                                | (Millions of Dollars)              |           |           | (Thousands, Except Degree Days) |          |          |
| Customer Class                 |                                    |           |           |                                 |          |          |
| Residential                    | \$993.4                            | \$977.1   | \$929.6   | 8,122.9                         | 8,448.1  | 8,586.6  |
| S m a l l                      | 881.8                              | 890.6     | 861.7     | 8,800.0                         | 9,260.3  | 9,430.3  |
| Commercial/Industrial          |                                    |           |           |                                 |          |          |
| L a r g e                      | 613.9                              | 659.6     | 676.9     | 9,348.4                         | 10,903.0 | 11,245.6 |
| Commercial/Industrial          |                                    |           |           |                                 |          |          |
| Other-Retail                   | 21.7                               | 21.2      | 19.7      | 162.9                           | 167.7    | 168.7    |
| Total Retail Sales             | 2,510.8                            | 2,548.5   | 2,487.9   | 26,434.2                        | 28,779.1 | 29,431.2 |
| Wholesale - Other              | 98.3                               | 58.9      | 95.1      | 1,180.2                         | 2,281.1  | 2,178.5  |
| Resale - Utilities             | 47.5                               | 37.5      | 81.6      | 1,548.9                         | 881.0    | 1,434.5  |
| Other Operating Revenues       | 55.7                               | 41.5      | 41.1      | -                               | -        | -        |
| Total                          | \$2,712.3                          | \$2,686.4 | \$2,705.7 | 29,163.3                        | 31,941.2 | 33,044.2 |
| Fuel and Purchased Power       |                                    |           |           |                                 |          |          |
| Fuel                           | 518.4                              | 570.8     | 570.1     |                                 |          |          |
| Purchased Power                | 537.3                              | 660.6     | 419.7     |                                 |          |          |
| Total Fuel and Purchased Power | 1,055.7                            | 1,231.4   | 989.8     |                                 |          |          |
| Total Electric Gross Margin    | \$1,656.6                          | \$1,455.0 | \$1,715.9 |                                 |          |          |
| Weather - Degree Days (a)      |                                    |           |           |                                 |          |          |
| Heating (6,640 Normal)         |                                    |           |           | 6,825                           | 7,073    | 6,508    |
| Cooling (698 Normal)           |                                    |           |           | 475                             | 593      | 800      |

(a) As measured at Mitchell International Airport in Milwaukee, Wisconsin. Normal degree days are based upon a 20-year moving average.

## Electric Utility Revenues and Sales

2009 vs. 2008:

Our electric utility operating revenue increased by \$25.9 million, or 1.0%, when compared to 2008. The most significant factors that caused a change in revenues were:

- 2009 pricing increases totaling approximately \$109.9 million reflecting the reduction of Point Beach credits to retail customers.

- A one-time FERC-approved refund to our wholesale customers in 2008 associated with their share of the gain on the sale of Point Beach that reduced 2008 wholesale revenues by \$62.5 million.
- Net pricing increases totaling approximately \$20.4 million related to Wisconsin and Michigan rate orders.
- Unfavorable weather that reduced electric revenues by an estimated \$35.3 million as compared to 2008.
- A slowdown in the economy that reduced commercial and industrial sales by an estimated \$129.0 million and wholesale sales by an estimated \$30.9 million.

Our total electric sales volumes decreased by approximately 8.7% as compared to 2008 due almost exclusively to a continued decline in economic conditions, which primarily affected our commercial and industrial sales, and milder weather, which primarily affected our residential sales. Total retail sales declined approximately 8.1%. Of the 8.1% decline in retail sales, approximately 7.0% relates to sales volumes at our large and small commercial and industrial customers. As measured by cooling degree days, 2009 was 19.9% cooler than 2008 and 31.9% cooler than normal.

We currently estimate that 2010 electric revenues will increase because of the impact of the 2010 PSCW rate increase, the reduction in the Point Beach bill credits and a slight increase in sales to large commercial and industrial customers as current economic conditions have improved slightly in our service territory. We would also expect residential sales to increase if we experience normal summer weather. However, we expect sales to small commercial and industrial customers to decrease slightly from 2009. For further information regarding the January

2010 PSCW rate order, see Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters -- 2010 Rate Case.

2008 vs. 2007:

Our electric utility operating revenues decreased by \$19.3 million, or 0.7%, when compared to 2007. The largest factor in this decline was a one-time \$62.5 million FERC-approved refund to our wholesale customers associated with their share of the gain on the sale of Point Beach. Consistent with past practices, the refund was recorded as a reduction in wholesale revenues. Because the refund came from the restricted cash associated with the sale of Point Beach, a corresponding entry was made to amortize the gain on the sale of Point Beach.

We also estimate that weather reduced our revenues by approximately \$28.3 million for the year ended December 31, 2008 as compared the same period in 2007. As measured by cooling degree days, 2008 was approximately 25.9% cooler than 2007 and 17.5% cooler than normal. Resale sales declined by approximately \$44.1 million primarily because of less favorable weather, which reduced demand for our higher cost generation that was not being utilized to serve our retail customers. In addition, we experienced a \$9.0 million decrease in revenue related to the settlement of a billing dispute with our largest customers, two iron ore mines, that occurred in 2007. Partially offsetting these decreases, we estimate that our electric revenues were approximately \$142.9 million higher than the same period in 2007 because of pricing increases we received in the January 2008 PSCW rate case, the interim April 2008 and final July 2008 PSCW fuel orders and a wholesale rate increase effective in May 2007.

Electric Fuel and Purchased Power Expenses

2009 vs. 2008:

Our electric fuel and purchased power costs decreased by \$175.7 million, or approximately 14.3%, when compared to 2008. This decline was primarily caused by lower MWh sales and lower natural gas and purchased power prices, partially offset by higher coal and transportation costs. Approximately \$41.2 million of this decrease related to the one-time amortization of deferred fuel costs recorded in the first quarter of 2008 pursuant to the January 2008 PSCW rate order. Adjusted for the one-time amortization, our electric fuel and purchased power costs decreased by \$134.5 million, or 10.9%.

We expect that electric fuel and purchased power expenses in 2010 will be impacted by the price of natural gas, changes in the cost of coal and related transportation prices and changes in electric sales.

2008 vs. 2007:

Our electric fuel and purchased power costs increased by \$241.6 million, or approximately 24.4%, when compared to 2007. The largest factor related to this increase was the power purchase agreement we entered into in connection with the sale of Point Beach, which increased costs by approximately \$247.0 million in 2008. In addition, in connection with the January 2008 PSCW rate order, we recorded a \$41.2 million one-time amortization of deferred fuel costs in the first quarter of 2008. After adjusting for the Point Beach power purchase agreement and one-time amortization of deferred fuel cost, fuel and purchased power costs decreased by approximately \$46.6 million, or 4.7%. Cost increases resulting from higher natural gas prices, purchased energy and coal and related transportation prices were more than offset by lower costs resulting from reduced MWh sales during 2008 as compared to 2007.

#### Gas Utility Revenues, Gross Margin and Therm Deliveries

The following table compares our total gas utility operating revenues and gross margin (total gas utility operating revenues less cost of gas sold) during 2009, 2008 and 2007:

| Gas Utility<br>Operations | 2009                  | 2008      | 2007      |
|---------------------------|-----------------------|-----------|-----------|
|                           | (Millions of Dollars) |           |           |
| Operating Revenues        | \$1,367.9             | \$1,694.6 | \$1,481.2 |
| Cost of Gas Sold          | 912.0                 | 1,220.9   | 1,052.3   |
| Gross Margin              | \$ 455.9              | \$ 473.7  | \$ 428.9  |

We believe gross margin is a better performance indicator than revenues because changes in the cost of gas sold flow through to revenue under GCRMs. The following table compares our gas utility gross margin and therm deliveries by customer class during 2009, 2008 and 2007:

| Gas Utility Operations | Gross Margin |      |      | Therm Deliveries |      |      |
|------------------------|--------------|------|------|------------------|------|------|
|                        | 2009         | 2008 | 2007 | 2009             | 2008 | 2007 |
|                        |              |      |      |                  |      |      |

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| Customer Class        | (Millions of Dollars) |         |         | (Millions, Except Degree Days) |         |         |
|-----------------------|-----------------------|---------|---------|--------------------------------|---------|---------|
|                       | 2009                  | 2008    | 2007    | 2009                           | 2008    | 2007    |
| Residential           | \$291.5               | \$299.5 | \$273.9 | 803.4                          | 841.8   | 791.7   |
| Commercial/Industrial | 104.6                 | 109.3   | 93.4    | 479.4                          | 503.2   | 461.9   |
| Interruptible         | 2.0                   | 2.4     | 2.0     | 19.1                           | 23.0    | 22.7    |
| Total Retail          | 398.1                 | 411.2   | 369.3   | 1,301.9                        | 1,368.0 | 1,276.3 |
| Transported Gas       | 49.6                  | 52.2    | 51.7    | 882.0                          | 905.8   | 921.6   |
| Other Operating       | 8.2                   | 10.3    | 7.9     | -                              | -       | -       |
| Total                 | \$455.9               | \$473.7 | \$428.9 | 2,183.9                        | 2,273.8 | 2,197.9 |

Weather - Degree Days

| (a)                    | 2009  | 2008  | 2007  |
|------------------------|-------|-------|-------|
| Heating (6,640 Normal) | 6,825 | 7,073 | 6,508 |

(a) As measured at Mitchell International Airport in Milwaukee, Wisconsin. Normal degree days are based upon a 20-year moving average.

2009 vs. 2008:

Our gas margin decreased by \$17.8 million, or approximately 3.8%, when compared to 2008. We estimate that milder winter weather and a decline in economic conditions caused margins to decrease by approximately \$14.4 million during 2009 as compared to 2008. As measured by heating degree days, 2009 was 3.5% warmer than 2008, but 2.8% colder than normal.

We expect our 2010 gas margins will be impacted by weather; however, as noted above, 2009 was colder than normal.

2008 vs. 2007:

Our gas margin increased by \$44.8 million, or approximately 10.4%, when compared to 2007. We estimate that approximately \$22.5 million of this increase related to pricing increases that we received in the January 2008 PSCW rate order. Additionally, we estimate that weather had a positive impact on our gas margin of approximately \$13.9 million. Temperatures (as measured by heating degree days) were 8.7% colder in 2008 as compared to 2007, and 5.9% colder than normal.

Other Operation and Maintenance Expense

2009 vs. 2008:

Our other operation and maintenance expense decreased by \$64.1 million, or approximately 4.4%, when compared to 2008. The largest factor for this decrease relates to a \$43.8 million one-time amortization of deferred bad debt costs in 2008 pursuant to the January 2008 PSCW rate order. The January 2008 PSCW rate order, which was in effect for all of 2009, allowed for pricing increases related to transmission costs, PTF lease costs and the amortization of other deferred costs. We estimate that these items were approximately \$15.9 million higher in 2009 as compared to 2008. The remaining decrease is primarily related to reduced operating and maintenance expenses at our power plants and electric distribution system.

Our utility operation and maintenance expenses are influenced by wage inflation, employee benefit costs, plant outages and amortization of regulatory assets. We expect our 2010 other operation and maintenance expenses to increase because of costs associated with the new Oak Creek units and regulatory amortizations.

2008 vs. 2007:

Our other operation and maintenance expenses increased by approximately \$278.2 million, or 23.7%, when compared to 2007. The January 2008 PSCW rate order allowed for pricing increases related to transmission costs, PTF lease costs and the amortization of other deferred costs. These items were \$262.8 million higher in 2008 as compared to 2007. In addition to these regulatory amortizations, in connection with the January 2008 PSCW rate order, we recorded a one-time \$43.8 million amortization of deferred bad debt costs in the first quarter of 2008. We also incurred approximately \$64.1 million of increased expenses related to the operation and maintenance of our power plants and electric distribution system. These increased costs were also considered in the

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rate setting process. These increases were partially offset by a \$119.7 million decrease in nuclear operation and maintenance expense related to Point Beach as we sold the plant in September 2007.

#### Depreciation, Decommissioning and Amortization Expense

2009 vs. 2008:

Depreciation, decommissioning and amortization expense increased by \$12.4 million, or approximately 4.1%, when compared to 2008. This increase was the result of higher depreciation related to new capital projects placed in service, including the Blue Sky Green Field wind project which was placed into service in May 2008.

We expect depreciation, decommissioning and amortization expense to decrease by approximately \$50 million in 2010 because of new depreciation rates that were implemented in connection with the January 2010 PSCW rate order. The new depreciation rates generally reflect longer lives for our utility assets.

2008 vs. 2007:

Depreciation, decommissioning and amortization expense decreased by approximately \$11.1 million, or 3.5%, when compared to 2007. The 2007 sale of Point Beach reduced depreciation, decommissioning and amortization expense by approximately \$24 million. Partially offsetting this decline was higher depreciation related to new projects including the Blue Sky Green Field wind project.

#### Amortization of Gain

In connection with the September 2007 sale of Point Beach, we reached agreements with our regulators to allow for the net gain on the sale to be used for the benefit of our customers. The majority of the benefits are being returned to customers in the form of bill credits. The net gain was originally recorded as a regulatory liability, and it is being amortized to the income statement as we issue bill credits or make refunds to customers. When the bill credits and refunds are issued to customers, we transfer cash from the restricted accounts to the unrestricted accounts, adjusted for taxes.

During 2009, 2008 and 2007, the Amortization of Gain was as follows:

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| Amortization of Gain                             | <u>2009</u>           | <u>2008</u>    | <u>2007</u>  |
|--|-----------------------|----------------|--------------|
|  | (Millions of Dollars) |                |              |
| Bill Credits - Retail                            | \$230.7               | \$340.6        | \$6.5        |
| One-Time FERC Refund                             | -                     | 62.5           | -            |
| One-Time Amortization to Offset Regulatory Asset | -                     | 85.0           | -            |
| Total Amortization of Gain                       | <u>\$230.7</u>        | <u>\$488.1</u> | <u>\$6.5</u> |

During 2010, we expect to see a reduction in the Amortization of Gain of approximately \$36.0 million related to the scheduled decrease in bill credits to retail customers compared to 2009. We expect that all remaining bill credits will be issued by the end of 2010.

NON-UTILITY ENERGY SEGMENT CONTRIBUTION TO OPERATING INCOME

The most significant subsidiary included in this segment is We Power, which constructs and owns power plants associated with our PTF strategy and leases them to Wisconsin Electric. This segment primarily reflects revenues billed under the leases for PWGS 1, PWGS 2 and the new Oak Creek coal handling and water intake systems and the related depreciation expense.

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| <u>Non Utility Energy Segment</u>              | <u>2009</u>           | <u>2008</u>   | <u>2007</u>   |
|--|-----------------------|---------------|---------------|
|  | (Millions of Dollars) |               |               |
| Operating Revenues                             | \$163.1               | \$126.2       | \$75.7        |
| Other Operating Expenses                       |                       |               |               |
| Other Operation and Maintenance                | 13.3                  | 14.6          | 15.9          |
| Depreciation, Decommissioning and Amortization | 29.2                  | 21.9          | 12.1          |
| Property and Revenue Taxes                     | 0.5                   | 0.4           | 0.3           |
| Operating Income                               | <u>\$120.1</u>        | <u>\$89.3</u> | <u>\$47.4</u> |

Note: We Power's PTF lease revenues and Wisconsin Electric's lease costs are eliminated in consolidation.

2009 vs. 2008:

Our non-utility energy segment contributed \$120.1 million of operating income in 2009 compared to operating income of \$89.3 million in 2008. This increase primarily relates to a full year of earnings from PWGS 2, which was placed in service in May 2008, and the earnings from the water intake system at Oak Creek, which was placed in service in January 2009.



In 2010, we expect our non-utility energy segment to generate significantly higher operating income in connection with our new coal plants. OC 1 was placed in service on February 2, 2010. Bechtel is targeting commercial operation of OC 2 by the end of August 2010.

2008 vs. 2007:

Our non-utility energy segment contributed \$89.3 million of operating income in 2008 compared to operating income of \$47.4 million in 2007. This increase was primarily related to lease income from PWGS 2 and the full year impact of the coal handling system for Oak Creek, which was placed in service in November 2007.

#### CORPORATE AND OTHER CONTRIBUTION TO OPERATING INCOME

2009 vs. 2008:

Corporate and other affiliates had an operating loss of \$10.7 million in 2009 compared with an operating loss of \$10.6 million in 2008. In the foreseeable future, we expect to have slight operating losses as we have minimal business operations in this segment.

2008 vs. 2007:

Corporate and other affiliates had an operating loss of \$10.6 million in 2008 compared with an operating loss of \$4.9 million in 2007. The increase in operating loss was primarily related to reduced real estate sales during 2008 as compared to 2007.

#### CONSOLIDATED OTHER INCOME AND DEDUCTIONS, NET

The following table identifies the components of consolidated other income and deductions, net during 2009, 2008 and 2007:

| <u>Other Income and Deductions, net</u> | <u>2009</u>           | <u>2008</u>   | <u>2007</u>   |
|---|-----------------------|---------------|---------------|
|   | (Millions of Dollars) |               |               |
| Carrying Costs                          | \$ -                  | \$ 0.8        | \$28.8        |
| Gain on Property Sales                  | 1.7                   | 2.6           | 13.1          |
| AFUDC - Equity                          | 16.0                  | 7.8           | 5.2           |
| Other, net                              | 10.7                  | 5.8           | 1.8           |
| Total Other Income and Deductions, net  | <u>\$28.4</u>         | <u>\$17.0</u> | <u>\$48.9</u> |

2009 vs. 2008:

Other income and deductions, net increased by \$11.4 million when compared to 2008 primarily due to higher interest income and an increase in AFUDC - Equity related to the construction of our Oak Creek AQCS

project. We expect to see an increase in AFUDC - Equity during 2010 with the continued construction of the Oak Creek AQCS project at Wisconsin Electric.

2008 vs. 2007:

Other income and deductions, net decreased by \$31.9 million when compared to 2007. We stopped accruing carrying charges on regulatory assets as the January 2008 PSCW rate order allowed a current return on them. Additionally, in 2007 we recognized approximately \$13.1 million on property sales, most of which related to land sales in northern Wisconsin and the Upper Peninsula of Michigan, as compared to \$2.6 million in 2008.

#### CONSOLIDATED INTEREST EXPENSE, NET

| <u>Interest Expense, net</u> | <u>2009</u>           | <u>2008</u>    | <u>2007</u>    |
|------------------------------|-----------------------|----------------|----------------|
|                              | (Millions of Dollars) |                |                |
| Gross Interest Costs         | \$235.4               | \$240.3        | \$240.9        |
| Less: Capitalized Interest   | 78.7                  | 86.6           | 73.3           |
| Interest Expense, net        | <u>\$156.7</u>        | <u>\$153.7</u> | <u>\$167.6</u> |

2009 vs. 2008:

Interest expense, net increased by \$3.0 million during 2009 when compared with 2008. Our gross interest costs decreased by \$4.9 million and our capitalized interest decreased by \$7.9 million primarily due to lower short-term interest rates and lower capital expenditures.

During 2010, we expect interest expense, net to increase significantly as we will stop capitalizing interest expense related to the Oak Creek units once they are placed into service. In addition, we expect to issue long-term debt and to use the net proceeds to repay the short-term borrowings that we incurred during the construction of the units.

2008 vs. 2007:

Interest expense, net decreased by \$13.9 million in 2008 when compared with 2007. Our gross interest costs decreased by \$0.6 million because of lower short-term interest rates that were offset in part by higher debt balances. Our capitalized interest increased \$13.3 million, primarily because of increased construction in progress at our Oak Creek units.

#### CONSOLIDATED INCOME TAXES

2009 vs. 2008:

Our effective tax rate applicable to continuing operations was 36.6% in 2009 compared to 37.7% in 2008. This reduction in our effective tax rate was the result of tax credits associated with wind production. For further information see Note H -- Income Taxes in the Notes to Consolidated Financial Statements. We expect our 2010 annual effective tax rate to range between 35.0% and 36.0%.

2008 vs. 2007:

Our effective tax rate applicable to continuing operations was 37.7% in 2008 compared to 39.1% in 2007. This reduction in our effective tax rate was primarily the result of increases in the production tax deductions and wind credits.

## LIQUIDITY AND CAPITAL RESOURCES

## CASH FLOWS

The following table summarizes our cash flows during 2009, 2008 and 2007:

| Wisconsin Energy<br>Corporation | 2009                  | 2008      | 2007      |
|---------------------------------|-----------------------|-----------|-----------|
|                                 | (Millions of Dollars) |           |           |
| Cash Provided by (Used<br>in)   |                       |           |           |
| Operating Activities            | \$628.8               | \$736.4   | \$532.4   |
| Investing Activities            | (\$736.1)             | (\$906.3) | (\$543.1) |
| Financing Activities            | \$95.7                | \$175.0   | \$1.1     |

## Operating Activities

2009 vs. 2008:

Cash provided by operating activities was \$628.8 million during 2009, which was \$107.6 million lower than 2008. Although we experienced an increase in net income and depreciation during 2009, our operating cash flows declined because of large contributions to our pension and post-retirement benefit plans. In January 2009, we contributed \$289.3 million to our benefit plans as compared to approximately \$48.4 million in 2008.

2008 vs. 2007:

Cash provided by operating activities was \$736.4 million during 2008 which was \$204.0 million higher than 2007, primarily because of higher cash earnings and lower tax payments.

During 2008, our cash earnings were higher than in 2007 because of increased amortizations of deferred costs associated with regulatory assets. During 2008, our cash taxes were \$289.2 million lower than 2007, primarily because of additional tax depreciation, increased deductions for contributions to our pension plan and deferred taxes associated with the nuclear decommissioning trust assets. In accordance with IRS guidelines, we completed a review in 2008 and concluded that certain timing items that historically had been capitalized and depreciated for tax purposes could be deducted currently. Our January 2009 contribution to our qualified pension plan resulted in a tax deduction for 2008.

## Investing Activities

2009 vs. 2008:

Cash used in investing activities was \$736.1 million during 2009, which was \$170.2 million lower than the same period in 2008. This decline primarily reflects lower capital expenditures and cash flows from the release of restricted cash related to the Point Beach bill credits during 2009.

During 2009, our capital expenditures decreased \$318.7 million, primarily due to the reduction in capital expenditures for OC 1 and OC 2 and the completion of PWGS 2 in 2008. During 2010, we expect our utility capital expenditures to increase because of the continued construction of the Oak Creek AQCS project and the start of construction of our recently approved Glacier Hills wind farm project. See Utility Rates and Regulatory Matters - Oak Creek Air Quality Control System Approval and - Renewable Energy Portfolio under Factors Affecting Results, Liquidity and Capital Resources for additional information on the projects.

During 2009, we released \$153.1 million less from restricted cash as compared to the same period in 2008. In September 2007, we sold Point Beach and placed approximately \$924 million of cash in restricted accounts to be used for the payment of taxes and for the benefit of our customers. We release the restricted cash, adjusted for taxes, as we issue bill credits to our customers, which is reflected as an amortization of the gain on our income statement. We expect to release approximately \$194.5 million of restricted cash during 2010 as we issue bill credits to our retail customers from the Point Beach proceeds.

2008 vs. 2007:

Cash used in investing activities was \$906.3 million during 2008, an increase of \$363.2 million over 2007. This increase reflects a reduction in proceeds from asset sales, partially offset by lower capital expenditures and an increase in restricted cash from the sale of Point Beach released to us. During 2008, we released \$345.1 million of restricted cash related to the Point Beach bill credits. In addition, our capital expenditures decreased \$73.8 million in 2008, primarily due to reduced construction spending related to our PTF generation plants. This was partially offset by increased spending at Wisconsin Electric related to the completion of

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our Blue Sky Green Field wind project and the start of construction of the Oak Creek AQCS project. Although, we experienced a significant inflow of cash in 2007 related to the sale of Point Beach, we restricted a significant amount of that cash until it is released as we issue bill credits.

The following table identifies capital expenditures by year:

| Capital<br>Expenditures       | 2009                  | 2008             | 2007             |
|-------------------------------|-----------------------|------------------|------------------|
|                               | (Millions of Dollars) |                  |                  |
| Utility                       | \$550.1               | \$606.7          | \$539.0          |
| We Power                      | 253.2                 | 529.3            | 667.3            |
| Other                         | 14.4                  | 0.4              | 3.9              |
| Total Capital<br>Expenditures | <u>\$817.7</u>        | <u>\$1,136.4</u> | <u>\$1,210.2</u> |

#### Financing Activities

The following table summarizes our cash flows from financing activities:

| <u>2009</u> | <u>2008</u> | <u>2007</u> |
|-------------|-------------|-------------|
|-------------|-------------|-------------|

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(Millions of Dollars)

|                              |               |                |              |
|------------------------------|---------------|----------------|--------------|
| Increase in Debt             | \$263.2       | \$316.8        | \$148.4      |
| Dividends on Common<br>Stock | (157.8)       | (126.3)        | (116.9)      |
| Common Stock, Net            | (12.6)        | (11.4)         | (31.7)       |
| Other                        | <u>2.9</u>    | <u>(4.1)</u>   | <u>1.3</u>   |
| Cash Provided by Financing   | <u>\$95.7</u> | <u>\$175.0</u> | <u>\$1.1</u> |

2009 vs. 2008:

Cash provided by financing activities during 2009 was \$95.7 million, compared to \$175.0 million during the same period in 2008. During 2009, we issued a total of \$261.5 million in long-term debt and retired \$74.1 million of long-term debt. Substantially all of the net proceeds were used to repay short-term debt. During 2009, we paid approximately \$157.8 million in cash dividends and Wisconsin Electric repurchased \$147 million of outstanding tax-exempt bonds in August 2009. For additional information on the debt issues and repurchase by Wisconsin Electric, see Note K -- Long-Term Debt in the Notes to Consolidated Financial Statements.

Our common stock dividends increased in 2009 as we raised our dividend rate by 25%. In January 2010, our Board of Directors approved an 18.5% increase in the quarterly common stock dividend.

2008 vs. 2007:

During 2008, cash provided by financing activities was \$175.0 million compared to \$1.1 million in 2007. During 2008, we issued a total of \$966 million in long-term debt and retired \$350.8 million of long-term debt. The net proceeds were used to repay short-term debt.

No new shares of Wisconsin Energy's common stock were issued in 2009, 2008 or 2007. During these years, our plan agents purchased, in the open market, 0.7 million shares at a cost of \$29.6 million, 0.5 million shares at a cost of \$23.0 million and 1.4 million shares at a cost of \$67.8 million, respectively, to fulfill exercised stock options and restricted stock awards. In 2009, 2008 and 2007, we received proceeds of \$17.0 million, \$11.6 million and \$36.1 million, respectively, related to the exercise of stock options. In addition, we instructed our independent agents to purchase shares of our common stock in the open market to satisfy our obligation under our dividend reinvestment plan and various employee benefit plans.

## CAPITAL RESOURCES AND REQUIREMENTS

In 2000, we announced a growth strategy which, among other things, called for us to sell certain assets and reduce our debt levels. Our debt to total capital ratio has decreased from 68.3% at September 30, 2000 to 58.1% at December 31, 2009 due, in large part, to these asset sales. Over the next several years, we expect to have some limited asset sales, but at levels significantly lower than prior years. For more information on some of these sales,

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including the sale of Edison Sault and our ownership interest in Edgewater Generating Unit 5, see Note D -- Asset Sales, Divestitures and Discontinued Operations in the Notes to Consolidated Financial Statements in this report.

Working Capital

As of December 31, 2009, our current liabilities exceeded our current assets by approximately \$420.2 million. This negative working capital balance is a result of financing the construction of OC 1 and OC 2 with significant amounts of short-term debt. OC 1 was placed into service on February 2, 2010. In February 2010, we issued \$530.0 million of long-term debt and used the net proceeds to repay short-term debt incurred to construct OC 1. We anticipate financing a portion of the construction costs of OC 2 with long-term debt upon commercial operation of OC 2. We expect these transactions to significantly improve our working capital position.

#### Capital Resources

We anticipate meeting our capital requirements during 2010 primarily through internally generated funds and short-term borrowings, supplemented by the issuance of intermediate or long-term debt securities depending on market conditions and other factors, including the Oak Creek financings discussed under Working Capital above. Beyond 2010, we anticipate meeting our capital requirements through internally generated funds supplemented, when required, by short-term borrowings and the issuance of debt securities.

We currently have access to the capital markets and have been able to generate funds internally and externally to meet our capital requirements. Our ability to attract the necessary financial capital at reasonable terms is critical to our overall strategic plan. We currently believe that we have adequate capacity to fund our operations for the foreseeable future through our existing borrowing arrangements, access to capital markets and internally generated cash.

Wisconsin Energy, Wisconsin Electric and Wisconsin Gas maintain bank back-up credit facilities, which provide liquidity support for each company's obligations with respect to commercial paper and for general corporate purposes.

An affiliate of Lehman Brothers Holdings, which filed for bankruptcy in September 2008, provided approximately \$80 million of commitments under our bank back-up credit facilities on a consolidated basis. We have no current plans to replace Lehman's commitments. Excluding Lehman's commitments, as of December 31, 2009, we had approximately \$1.6 billion of available, undrawn lines under our bank back-up credit facilities. As of December 31, 2009, we had approximately \$820.9 million of commercial paper outstanding on a consolidated basis that was supported by the available lines of credit.

We review our bank back-up credit facility needs on an ongoing basis and expect to be able to maintain adequate credit facilities to support our operations. The following table summarizes such facilities as of December 31, 2009:

| <u>Company</u>        | <u>Total Facility *</u> | <u>Letters of Credit</u> | <u>Credit Available *</u> | <u>Facility Expiration</u> |
|-----------------------|-------------------------|--------------------------|---------------------------|----------------------------|
| (Millions of Dollars) |                         |                          |                           |                            |
| Wisconsin Energy      | \$857.5                 | \$1.1                    | \$856.4                   | April 2011                 |
| Wisconsin Electric    | \$476.4                 | \$2.4                    | \$474.0                   | March 2011                 |
| Wisconsin Gas         | \$285.8                 | \$ -                     | \$285.8                   | March 2011                 |

\* Excludes Lehman's commitments

Each of these facilities has a renewal provision for two one-year extensions.

The following table shows our capitalization structure as of December 31, 2009 and 2008, as well as an adjusted

capitalization structure that we believe is consistent with the manner in which the rating agencies currently view the Junior Notes:

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| Capitalization Structure                      | 2009                  |                  | 2008             |                  |
|---|-----------------------|------------------|------------------|------------------|
|   | Actual                | Adjusted         | Actual           | Adjusted         |
|   | (Millions of Dollars) |                  |                  |                  |
| Common Equity                                 | \$3,566.9             | \$3,816.9        | \$3,336.9        | \$3,586.9        |
| Preferred Stock of Subsidiary                 | 30.4                  | 30.4             | 30.4             | 30.4             |
| Long-Term Debt (including current maturities) | 4,171.5               | 3,921.5          | 4,136.5          | 3,886.5          |
| Short-Term Debt                               | <u>825.1</u>          | <u>825.1</u>     | <u>602.3</u>     | <u>602.3</u>     |
| Total Capitalization                          | <u>\$8,593.9</u>      | <u>\$8,593.9</u> | <u>\$8,106.1</u> | <u>\$8,106.1</u> |
| Total Debt                                    | \$4,996.6             | \$4,746.6        | \$4,738.8        | \$4,488.8        |

Ratio of Debt to Total Capitalization 58.1% 55.2% 58.5% 55.4%

Included in Long-Term Debt on our Consolidated Balance Sheet as of December 31, 2009 and 2008, is \$500 million aggregate principal amount of the Junior Notes. The adjusted presentation attributes \$250 million of the Junior Notes to Common Equity and \$250 million to Long-Term Debt. We believe this presentation is consistent with the 50% equity credit the majority of rating agencies currently attribute to the Junior Notes.

The adjusted presentation of our consolidated capitalization structure is presented as a complement to our capitalization structure presented in accordance with GAAP. Management evaluates and manages Wisconsin Energy's capitalization structure, including its total debt to total capitalization ratio, using the GAAP calculation as adjusted by the rating agency treatment of the Junior Notes. Therefore, we believe the non-GAAP adjusted presentation reflecting this treatment is useful and relevant to investors in understanding how management and the rating agencies evaluate our capitalization structure.

As described in Note J -- Common Equity, in the Notes to Consolidated Financial Statements, certain restrictions exist on the ability of our subsidiaries to transfer funds to us. We do not expect these restrictions to have any material effect on our operations or ability to meet our cash obligations.

Wisconsin Electric is the obligor under two series of tax exempt pollution control refunding bonds in outstanding principal amounts of \$147 million. In August 2009, Wisconsin Electric terminated letters of credit that provided credit and liquidity support for the bonds, which resulted in a mandatory tender of the bonds. Wisconsin Electric issued commercial paper to fund the purchase of the bonds. As of December 31, 2009, the repurchased bonds were still outstanding, but were reported as a reduction in our consolidated long-term debt because they are held by Wisconsin Electric. Depending on market conditions and other factors, Wisconsin Electric may change the method used to determine the interest rate on the bonds and have them remarketed to third parties.

Access to capital markets at a reasonable cost is determined in large part by credit quality. The following table summarizes the ratings of our debt securities and the debt securities and preferred stock of our subsidiaries by S&P, Moody's and Fitch as of December 31, 2009:

|                                      | <u>S&amp;P</u> | <u>Moody's</u> | <u>Fitch</u> |
|--------------------------------------|----------------|----------------|--------------|
| Wisconsin Energy                     |                |                |              |
| Commercial Paper                     | A-2            | P-2            | F2           |
| Unsecured Senior Debt                | BBB+           | A3             | A-           |
| Unsecured Junior Notes               | BBB-           | Baa1           | BBB+         |
| Wisconsin Electric                   |                |                |              |
| Commercial Paper                     | A-2            | P-1            | F1           |
| Secured Senior Debt                  | A-             | Aa3            | AA-          |
| Unsecured Debt                       | A-             | A1             | A+           |
| Preferred Stock                      | BBB            | A3             | A            |
| Wisconsin Gas                        |                |                |              |
| Commercial Paper                     | A-2            | P-1            | F1           |
| Unsecured Senior Debt                | A-             | A1             | A+           |
| Wisconsin Energy Capital Corporation |                |                |              |
| Unsecured Debt                       | BBB+           | A3             | A-           |

In February 2010, S&P, Moody's and Fitch rated ERGSS' Senior Notes A-, A1 and A+, respectively. The ratings outlook assigned by S&P, Moody's and Fitch to ERGSS is stable, stable and negative, respectively.

In July 2009, S&P affirmed the ratings of Wisconsin Energy, Wisconsin Electric, Wisconsin Gas and Wisconsin Energy Capital Corporation and revised the ratings outlooks assigned to each company from positive to stable.

In June 2009, Fitch affirmed the ratings of Wisconsin Energy, Wisconsin Electric, Wisconsin Gas and Wisconsin Energy Capital Corporation and the stable ratings outlook of Wisconsin Gas. Fitch also revised the ratings outlooks of Wisconsin Energy, Wisconsin Electric and Wisconsin Energy Capital Corporation from stable to negative.

The security rating outlooks assigned by Moody's for Wisconsin Energy, Wisconsin Electric, Wisconsin Gas and Wisconsin Energy Capital Corporation are all stable.

Subject to other factors affecting the credit markets as a whole, we believe these security ratings should provide a significant degree of flexibility in obtaining funds on competitive terms. However, these security ratings reflect the views of the rating agencies only. An explanation of the significance of these ratings may be obtained from each rating agency. Such ratings are not a recommendation to buy, sell or hold securities, but rather an indication of creditworthiness. Any rating can be revised upward or downward or withdrawn at any time by a rating agency if it decides that the circumstances warrant the change. Each rating should be evaluated independently of any other rating.



## Capital Requirements

Our estimated 2010, 2011 and 2012 capital expenditures are as follows:

| Capital<br>Expenditures | 2010    | 2011                  | 2012    |
|-------------------------|---------|-----------------------|---------|
|                         |         |                       |         |
|                         |         | (Millions of Dollars) |         |
| Utility                 |         |                       |         |
| Renewable               | \$96.6  | \$392.8               | \$289.6 |
| Environmental           | 301.7   | 170.6                 | 69.2    |
| Base Spending           | 406.2   | 436.0                 | 445.3   |
| Total Utility           | 804.5   | 999.4                 | 804.1   |
| We Power                | 136.2   | 13.1                  | 25.7    |
| Other                   | 9.8     | 5.1                   | 5.1     |
| Total                   | \$950.5 | \$1,017.6             | \$834.9 |

Changing environmental and other regulations such as air quality standards and renewable energy standards and electric reliability initiatives that impact our utility energy segment may cause actual future long-term capital requirements to vary from these estimates.

### Investments in Outside Trusts:

We use outside trusts to fund our pension and certain other post-retirement obligations. These trusts had investments of approximately \$1.2 billion as of December 31, 2009. These trusts hold investments that are subject to the volatility of the stock market and interest rates.

In January 2009, we contributed \$270 million to our qualified pension plans due to poor investment returns during 2008. We do not expect to make contributions to the plans during 2010 as they are adequately funded. Future contributions to the plans will be dependent upon many factors, including the performance of existing plan assets and long-term discount rates. For additional information, see Note O -- Benefits in the Notes to Consolidated Financial Statements.

### Off-Balance Sheet Arrangements:

We are a party to various financial instruments with off-balance sheet risk as a part of our normal course of business, including financial guarantees and letters of credit which support construction projects, commodity contracts and other payment obligations. We believe that these agreements do not have, and are not reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our investors. For additional information, see Note P -- Guarantees in the Notes to Consolidated Financial Statements.

We have identified two tolling and purchased power agreements with third parties but have been unable to determine if we are the primary beneficiary of these two variable interest entities. The requested information required to make this determination has not been supplied. As a result, we do not consolidate these entities. We account for one of these

contracts as a capital lease and for the other contract as an operating lease, and both are reflected in the Contractual Obligations/Commercial Commitments table below. For additional information, see Note G -- Variable Interest Entities in the Notes to Consolidated Financial Statements.

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### Contractual Obligations/Commercial Commitments:

We have the following contractual obligations and other commercial commitments as of December 31, 2009:

| Contractual Obligations<br>(a)           | Payments Due by Period |                     |                  |                  |                      |
|--|------------------------|---------------------|------------------|------------------|----------------------|
|  | Total                  | Less than<br>1 year | 1-3 years        | 3-5 years        | More than<br>5 years |
|  | (Millions of Dollars)  |                     |                  |                  |                      |
| Long-Term Debt<br>Obligations (b)        | \$7,115.8              | \$513.4             | \$860.1          | \$1,036.3        | \$4,706.0            |
| Capital Lease<br>Obligations (c)         | 369.0                  | 36.2                | 76.5             | 82.3             | 174.0                |
| Operating Lease<br>Obligations (d)       | 76.0                   | 21.3                | 36.6             | 8.4              | 9.7                  |
| Purchase Obligations (e)                 | 13,807.3               | 1,345.7             | 1,492.6          | 930.8            | 10,038.2             |
| Other Long-Term<br>Liabilities (f)       | 85.2                   | 84.5                | 0.7              | -                | -                    |
| <b>Total Contractual<br/>Obligations</b> | <b>\$21,453.3</b>      | <b>\$2,001.1</b>    | <b>\$2,466.5</b> | <b>\$2,057.8</b> | <b>\$14,927.9</b>    |

- (a) The amounts included in the table are calculated using current market prices, forward curves and other estimates.
- (b) Principal and interest payments on Long-Term Debt (excluding capital lease obligations). For the purpose of determining our contractual obligations and commercial commitments only, we assumed the Junior Notes would be retired in 2017 with the proceeds from the issuance of qualifying securities pursuant to the terms of the RCC.
- (c) Capital Lease Obligations of Wisconsin Electric for power purchase commitments.
- (d) Operating Lease Obligations for power purchase commitments and vehicle and rail car leases.
- (e) Purchase Obligations under various contracts for the procurement of fuel, power, gas supply and associated transportation related to utility operations and for construction, information technology and other services for utility and We Power operations. This includes the power purchase agreement for all of the energy produced by Point Beach.

- (f) Other Long-Term Liabilities includes the expected 2010 supplemental executive retirement plan obligation. For additional information on employer contributions to our benefit plans, see Note O -- Benefits in the Notes to Consolidated Financial Statements.

The table above does not include liabilities related to the accounting treatment for uncertainty in income taxes. For additional information regarding these liabilities, refer to Note H -- Income Taxes in the Notes to Consolidated Financial Statements in this report.

Obligations for utility operations have historically been included as part of the rate making process and therefore are generally recoverable from customers.

## FACTORS AFFECTING RESULTS, LIQUIDITY AND CAPITAL RESOURCES

### MARKET RISKS AND OTHER SIGNIFICANT RISKS

We are exposed to market and other significant risks as a result of the nature of our businesses and the environment in which those businesses operate. These risks, described in further detail below, include but are not limited to:

#### Large Construction Projects:

In November 2003, the PSCW issued a written order granting a CPCN to commence construction of two 615 MW supercritical pulverized coal generating units adjacent to the site of Wisconsin Electric's existing Oak Creek Power Plant. The order approves key financial terms of the leased generation contracts including a target construction cost of the Oak Creek expansion of \$2.191 billion, plus, subject to PSCW approval, cost over-runs of up to 5%, costs attributable to force majeure events, excused events and event of loss provisions. OC 1 was placed into service on February 2, 2010. Bechtel is targeting the commercial operation of OC 2 by the end of August 2010. For additional information, see *Power the Future* -- Oak Creek Expansion.

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Large construction projects of this type, as well as the construction of renewable energy generation and environmental improvements, are subject to usual construction risks over which we will have limited or no control and which might adversely affect project costs and completion time. These risks include, but are not limited to, shortages of, the inability to obtain or the cost of labor or materials, the ability of the general contractor or subcontractors to perform under their contracts, strikes, adverse weather conditions, legal challenges, changes in applicable law or regulations, adverse interpretation or enforcement of permit conditions, laws and regulations by the courts or permitting agencies, the inability to obtain necessary operating permits in a timely manner, other governmental actions and events in the global economy.

If final costs of the Oak Creek expansion are within 5% of the costs initially approved by the PSCW, and the additional costs are deemed to be prudent by the PSCW, the final lease payments for the Oak Creek expansion recovered from Wisconsin Electric would be adjusted to reflect the actual construction costs. Any costs above the 5% cap would also be included in lease payments and recovered from customers if the PSCW finds that such costs were prudently incurred and were the result of force majeure conditions, an excused event and/or an event of loss. Once the units are completed, and in light of the weather delays incurred on the project, we expect to request authorization from the PSCW to recover all costs associated with the units. See *Power the Future* -- Oak Creek Expansion below for a discussion of the Settlement Agreement entered into with Bechtel.

### Regulatory Recovery:

Our utility energy segment accounts for its regulated operations in accordance with accounting guidance for regulated entities. Our rates are determined by regulatory authorities. Our primary regulator is the PSCW. Regulated entities are allowed to defer certain costs that would otherwise be charged to expense, if the regulated entity believes the recovery of these costs is probable. We record regulatory assets pursuant to specific orders or by a generic order issued by our regulators, and recovery of these deferred costs in future rates is subject to the review and approval of those regulators. We assume the risks and benefits of ultimate recovery of these items in future rates. If the recovery of these costs is not approved by our regulators, the costs are charged to income in the current period. We expect to recover our outstanding regulatory assets in rates over a period of no longer than 20 years. Regulators can impose liabilities on a prospective basis for amounts previously collected from customers and for amounts that are expected to be refunded to customers. We record these items as regulatory liabilities.

### Commodity Prices:

In the normal course of providing energy, we are subject to market fluctuations of the costs of coal, natural gas, purchased power and fuel oil used in the delivery of coal. We manage our fuel and gas supply costs through a portfolio of short and long-term procurement contracts with various suppliers for the purchase of coal, natural gas and fuel oil. In addition, we manage the risk of price volatility by utilizing gas and electric hedging programs.

Wisconsin's retail electric fuel cost adjustment procedure mitigates some of Wisconsin Electric's risk of electric fuel cost fluctuation. If cumulative fuel and purchased power costs for electric utility operations deviate from a prescribed range (plus or minus 2% for 2010) when compared to the costs projected in the most recent retail rate proceeding, retail electric rates may be adjusted prospectively. For information regarding the current fuel rules, see Utility Rates and Regulatory Matters.

The PSCW has authorized dollar for dollar recovery for the majority of natural gas costs for our gas utility operations through GCRMs, which mitigates most of the risk of gas cost variations. For information concerning the natural gas utilities' GCRMs, see Utility Rates and Regulatory Matters.

### Natural Gas Costs:

Higher natural gas costs increase our working capital requirements and result in higher gross receipts taxes in the state of Wisconsin. Higher natural gas costs combined with slower economic conditions also expose us to greater risks of accounts receivable write-offs as more customers are unable to pay their bills.

In March 2005, the PSCW authorized the use of the escrow method of accounting for bad debt costs allowing for deferral of Wisconsin residential bad debt expense that exceeds amounts allowed in rates. As part of the January 2010 PSCW rate order, the PSCW authorized continued use of the escrow method of accounting for bad debt costs through December 31, 2011.

As a result of GCRMs, our gas distribution subsidiaries receive dollar for dollar recovery on the cost of natural gas. However, increased natural gas costs increase the risk that customers will switch to alternative fuel sources, which could reduce future gas margins.

### Weather:

Our Wisconsin utility rates are set by the PSCW based upon estimated temperatures which approximate 20-year averages. Wisconsin Electric's electric revenues and sales are unfavorably sensitive to below normal temperatures during the summer cooling season, and to some extent, to above normal temperatures during the winter heating season. Our gas revenues and sales are unfavorably sensitive to above normal temperatures

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during the winter heating season. A summary of actual weather information in the utility segment's service territory during 2009, 2008 and 2007, as measured by degree days, may be found above in Results of Operations.

### Interest Rate:

We have various short-term borrowing arrangements to provide working capital and general corporate funds. We also have variable rate long-term debt outstanding as of December 31, 2009. Borrowing levels under these arrangements vary from period to period depending on capital investments and other factors. Future short-term interest expense and payments will reflect both future short-term interest rates and borrowing levels.

We performed an interest rate sensitivity analysis at December 31, 2009 of our outstanding portfolio of \$820.9 million of commercial paper with a weighted-average interest rate of 0.28% and \$407.0 million of variable-rate long-term debt with a weighted average interest rate of 1.93%. A one-percentage point change in interest rates would cause our annual interest expense to increase or decrease by approximately \$8.2 million before taxes from short-term borrowings and \$4.1 million before taxes from variable-rate long-term debt outstanding.

### Marketable Securities Return:

We use various trusts to fund our pension and OPEB obligations. These trusts invest in debt and equity securities. Changes in the market prices of these assets can affect future pension and OPEB expenses. Additionally, future contributions can also be affected by the investment returns on trust fund assets. We believe that the financial risks associated with investment returns would be partially mitigated through future rate actions by our various utility regulators.

The fair value of our trust fund assets as of December 31, 2009 was approximately:

| <u>Wisconsin Energy Corporation</u>        | <u>Millions of Dollars</u> |
|--|----------------------------|
| Pension trust funds                        | \$1,026.0                  |
| Other post-retirement benefits trust funds | \$202.6                    |

The expected long-term rate of return on plan assets was 8.25% for both the pension and other post-retirement benefits for 2009. During 2009, we contributed \$270 million to our pension plans which brought the plans close to fully funded under the Pension Protection Act. As a result, we changed our asset mix to a higher weighting of fixed income securities and a lower weighting of equity securities. In 2010, our expected long-term rate of return on the pension plan assets is 7.25% reflecting the change in asset allocations. The lower expected return on plan assets will increase 2010 pension costs by approximately \$10 million; however, increased pension expense was considered in the rate setting process by the PSCW.

Fiduciary oversight of the pension and OPEB trust fund investments is the responsibility of an Investment Trust Policy Committee. The Committee works with external actuaries and investment consultants on an ongoing basis to establish and monitor investment strategies and target asset allocations. Forecasted cash flows for plan liabilities are regularly updated based on annual valuation results. Target asset allocations are determined utilizing projected benefit payment cash flows and risk analyses of appropriate investments. The targeted asset allocations are intended to reduce risk, provide long-term financial stability for the plans and maintain funded levels which meet long-term plan obligations while preserving sufficient liquidity for near-term benefit payments. Investment strategies utilize a wide diversification of asset types and qualified external investment managers.

Subsequent to our last asset/liability study completed in 2005, we have consulted with our investment advisors on an annual basis and requested them to forecast expected long-term returns on plan assets by reviewing actual historical returns and calculating expected total trust returns using the weighted-average of long-term market returns for each of the major target asset categories utilized in the fund.

**Credit Ratings:**

We do not have any credit agreements that would require material changes in payment schedules or terminations as a result of a credit rating downgrade. We do have certain agreements in the form of commodity contracts and employee benefit plans that could require collateral or a termination payment only in the event of a credit rating change to below investment grade. As of December 31, 2009, we estimate that the collateral or the termination payment required under these agreements totaled approximately \$196.9 million. In addition, we have

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commodity contracts that in the event of a credit rating downgrade could result in a reduction of our unsecured credit granted by counterparties.

**Economic Conditions:**

Our service territory is within the state of Wisconsin and the Upper Peninsula of Michigan. We are exposed to market risks in the regional midwest economy.

**Inflation:**

We continue to monitor the impact of inflation, especially with respect to the costs of medical plans, fuel, transmission access, construction costs, regulatory and environmental compliance and new generation in order to minimize its effects in future years through pricing strategies, productivity improvements and cost reductions. We do not believe the impact of general inflation will have a material impact on our future results of operations.

For additional information concerning risk factors, including market risks, see the Cautionary Statement Regarding Forward-Looking Information at the beginning of this report and Risk Factors in Item 1A.

**POWER THE FUTURE**

Under our PTF strategy, we expect to meet a significant portion of our future generation needs through the construction of the PWGS and the Oak Creek expansion by We Power. The PTF units include PWGS 1, PWGS 2, OC 1 and OC 2. The following tables identify certain key items related to the units:

| Unit Name | In Service | Cash Costs (a) |
|-----------|------------|----------------|
| PWGS 1    | July 2005  | \$ 333 million |
| PWGS 2    | May 2008   | \$ 331 million |

  

| Unit Name | Scheduled In Service   | Approximate Cash Costs (a) |
|-----------|------------------------|----------------------------|
| OC 1      | February 2010 (Actual) | \$ 1,346 million           |
| OC 2      | August 2010            | \$ 670 million             |

- (a) Cash costs represent actual and current projected costs, excluding capitalized interest. Approximate costs for OC 1 and OC 2 include the cost of the settlement agreement with Bechtel adjusted for our ownership percentage.

We are recovering our costs in these units through lease payments that are billed from We Power to Wisconsin Electric and then recovered in Wisconsin Electric's rates. The lease payments are based on the cash costs authorized by the PSCW. Under the lease terms, our return is calculated using a 12.7% return on equity and the equity ratio is assumed to be 53% for the PWGS Units and 55% for the Oak Creek Units. The interest component of the return is determined up to 180 days prior to the date that the units are placed in service.

Power the Future -

#### **Port Washington**

##### **Background:**

In December 2002, the PSCW issued a written order (the Port Order) granting a CPCN for the construction of PWGS consisting of two 545 MW natural gas-fired combined cycle generating units on the site of Wisconsin Electric's existing Port Washington Power Plant, the natural gas lateral to supply the new plant, and the transmission system upgrades required of ATC. PWGS 1 and PWGS 2 were completed within the PSCW approved cost parameters and were placed in service in July 2005 and May 2008, respectively.

##### **Lease Terms:**

The PSCW approved the lease agreements and related documents under which Wisconsin Electric will staff, operate and maintain PWGS 1 and PWGS 2. Key terms of the leased generation contracts include:

- Initial lease term of 25 years with the potential for subsequent renewals at reduced rates;
- Cost recovery over a 25 year period on a mortgage basis amortization schedule;
- Imputed capital structure of 53% equity, 47% debt;
- Authorized rate of return of 12.7% after tax on equity;
- Fixed construction cost of PWGS 1 and PWGS 2 at \$309.6 million and \$280.3 million (2001 dollars) subject to escalation at the GDP inflation rate;
- Recovery of carrying costs during construction; and

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- Ongoing PSCW supervisory authority over those lease terms and conditions specifically identified in the Port Order, which do not include the key financial terms.

Power the Future -

#### **Oak Creek Expansion**

##### **Background:**

In November 2003, the PSCW issued an order (the Oak Creek Order) granting Wisconsin Energy, Wisconsin Electric and We Power a CPCN to commence construction of two 615 MW coal-fired units (the Oak Creek expansion) to be located adjacent to the site of Wisconsin Electric's existing Oak Creek Power Plant. OC 1 was placed into service on February 2, 2010. Bechtel is currently targeting the commercial operation of OC 2 by the end of August 2010. The total cost for the two units was set at \$2.191 billion, and the order provided for recovery of excess costs of up to 5% of the total project, subject to a prudence review by the PSCW. Costs above the 5% cap would also be included in lease payments and recovered from customers if the PSCW finds that such costs were prudently incurred and were the result of force majeure conditions, an excused event and/or event of loss.

In June 2005, construction commenced at the site. In November 2005, we completed the sale of approximately a 17% interest in the two units to two unaffiliated entities, who share ratably in the construction costs. Although these two unaffiliated entities have a combined ownership interest in approximately 17% of the MWs generated by the two

units, they only have a 15% ownership interest in the Oak Creek expansion as a whole, taking into account the common facilities being constructed, including the coal handling and water intake systems.

The Oak Creek expansion includes a new coal handling system that will serve both the existing units at Oak Creek and OC 1 and OC 2. The new coal handling system was placed into service during the fourth quarter of 2007 at a cost of approximately \$199.1 million.

The Oak Creek expansion also includes a new water intake system that will serve both the existing units at Oak Creek and OC 1 and OC 2. The new water intake system was placed into service in January 2009 at a cost of approximately \$132.6 million.

#### Lease Terms:

In October 2004, the PSCW approved the leased generation contracts between Wisconsin Electric and We Power for OC 1 and OC 2. Key terms of the leased generation contracts include:

- Initial lease term of 30 years with the potential for subsequent renewals at reduced rates;
- Cost recovery over a 30 year period on a mortgage basis amortization schedule with the potential for subsequent renewals at reduced rates;
- Imputed capital structure of 55% equity, 45% debt;
- Authorized rate of return of 12.7% after tax on equity;
- Recovery of carrying costs during construction; and
- Ongoing PSCW supervisory authority over those lease terms and conditions specifically identified in the Oak Creek Order, which do not include the key financial terms.

#### Construction Status:

Bechtel, the contractor of the Oak Creek expansion under a fixed price contract, submitted claims to us for schedule and cost relief on December 22, 2008 related to the delay of the in-service dates for OC 1 and OC 2. These claims were asserted against ERS, the project manager for the construction of the Oak Creek expansion and agent for the joint owners of OC 1 and OC 2. On October 30, 2009, Bechtel amended its claim to increase its request for cost and schedule relief. In its amended claim, Bechtel requested cost relief totaling approximately \$517.5 million and schedule relief that would have resulted in approximately seven months of relief from liquidated damages beyond the guaranteed in-service date of September 29, 2009 for OC 1 and approximately four months of relief from liquidated damages beyond the guaranteed in-service date of September 29, 2010 for OC 2.

Bechtel's first claim was based on the alleged impact of severe weather and certain labor-related matters. Pursuant to its amended claim, Bechtel was requesting approximately \$445.5 million in costs related to changed weather and labor conditions. Bechtel's second claim of approximately \$72 million sought cost and schedule relief for the alleged effects of ERS-directed changes and delays allegedly caused by ERS prior to the issuance of the Full Notice to Proceed in July 2005. These claims, as well as claims submitted by ERS related to the rights of the parties under the construction contract and ERS counterclaims, had been submitted to binding arbitration.

Effective December 16, 2009, ERS and Bechtel entered into the Settlement Agreement that settled all claims between them regarding OC 1 and OC 2. Pursuant to the terms of this Settlement Agreement, ERS will pay to Bechtel \$72 million to settle these claims, with \$10 million already paid in 2009 and the remaining \$62 million to be paid in six additional installments upon the achievement of specific project milestones. In addition, Bechtel will receive 120 days of schedule relief for OC 1 and 60 days for OC 2. Therefore, the guaranteed in-service date of September 29, 2009 for OC 1 was extended to January 27, 2010, and the guaranteed in-service date of September 29, 2010 for OC 2 was extended to November 28, 2010.



We are responsible for approximately 85% of amounts paid under the Settlement Agreement, consistent with our ownership share of the Oak Creek expansion. The other joint owners are responsible for the remainder.

OC 1 was placed into service on February 2, 2010. Bechtel is currently targeting commercial operation of OC 2 by the end of August 2010.

The Settlement Agreement also provides for Bechtel's release of ERS from all matters related to Bechtel's claims, among other things, and for ERS' release of Bechtel from all matters related to ERS' claims that were subject to arbitration, among other things.

#### WPDES Permit:

In July 2008, in order to resolve all outstanding challenges to the WPDES permit issued by the WDNR in connection with the Oak Creek expansion, we and with the other two joint owners of the Oak Creek expansion reached an agreement with Clean Wisconsin, Inc. and Sierra Club, the groups who were opposing the WPDES permit. Under the settlement agreement, these groups agreed to withdraw their opposition to the modified WPDES permit issued in July 2008 for the existing and expansion units at Oak Creek.

In the agreement with Clean Wisconsin, Inc. and Sierra Club, we committed to contribute our share of \$5 million (approximately \$4.2 million) towards projects to reduce greenhouse gas emissions. We also agreed (i) for the 25 year period ending 2034, subject to regulatory approval and cost recovery, to contribute our share of up to \$4 million per year (approximately \$3.3 million) to fund projects to address Lake Michigan water quality, and (ii) subject to regulatory approval and cost recovery, to develop new solar and biomass generation projects. We also agreed to support state legislation to increase the renewable portfolio standard to 10% by 2013 and 25% by 2025, and to retire 116 MW of coal-fired generation at our Presque Isle Power Plant.

In its December 2009 decision, based upon a proposal submitted by the parties to the settlement agreement, the PSCW authorized recovery of \$2.0 million per year for 2010 and 2011 related to costs associated with projects to address Lake Michigan water quality and recovery of \$2.0 million of the second \$2.5 million payment related to projects to reduce greenhouse gas emissions. Based upon this decision, the parties are proceeding to implement the settlement agreement. We are responsible for our pro rata share of these payments.

#### UTILITY RATES AND REGULATORY MATTERS

The PSCW regulates our retail electric, natural gas, steam and water rates in the state of Wisconsin, while FERC regulates our wholesale power, electric transmission and interstate gas transportation service rates. The MPSC regulates our retail electric rates in the state of Michigan. Within our regulated segment, we estimate that approximately 88% of our electric revenues are regulated by the PSCW, 7% are regulated by the MPSC and the balance of our electric revenues is regulated by FERC. All of our natural gas and steam revenues are regulated by the PSCW. Orders from the PSCW can be viewed at <http://psc.wi.gov/> and orders from the MPSC can be viewed at [www.michigan.gov/mpsc/](http://www.michigan.gov/mpsc/).

#### 2010 Wisconsin Rate Case:

In March 2009, Wisconsin Electric and Wisconsin Gas initiated rate proceedings with the PSCW. Wisconsin Electric initially asked the PSCW to approve a rate increase for its Wisconsin retail electric customers of approximately \$76.5 million, or 2.8%, and a rate increase for its natural gas customers of approximately \$22.1 million, or 3.6%. In addition, Wisconsin Electric requested increases of approximately \$1.4 million, or 5.8%, and approximately \$1.3 million, or 6.8%, for its Valley steam utility customers and Milwaukee County steam utility customers, respectively. Wisconsin Gas asked the PSCW to approve a rate increase for its natural gas customers of approximately \$38.9 million, or 4.6%.

In July 2009, Wisconsin Electric filed supplemental testimony with the PSCW updating its rate increase request for retail electric customers to reflect the impact of lower sales as a result of the decline in the economy. The effect of the change resulted in Wisconsin Electric increasing its request from \$76.5 million to \$126.0 million.

In December 2009, the PSCW authorized rate adjustments related to Wisconsin Electric's and Wisconsin Gas' requests to increase electric, natural gas and steam rates. The PSCW approved the following rate adjustments:

- An increase of approximately \$85.8 million (3.35%) in retail electric rates for Wisconsin Electric;
- A decrease of approximately \$2.0 million (0.35%) for natural gas service for Wisconsin Electric;
- An increase of approximately \$5.7 million (0.70%) for natural gas service for Wisconsin Gas; and
- A decrease of approximately \$0.4 million (1.65%) for Wisconsin Electric's Downtown Milwaukee (Valley) steam utility customers and a decrease of approximately \$0.1 million (0.47%) for its Milwaukee County steam utility customers.

These rate adjustments became effective January 1, 2010. In addition, the PSCW lowered the return on equity for Wisconsin Electric from 10.75% to 10.4% and for Wisconsin Gas from 10.75% to 10.5%.

The PSCW also made, among others, the following determinations:

- New depreciation rates are incorporated into the new base rates approved in the rate case;
- Certain regulatory assets currently scheduled to be fully amortized over the next four years are to instead be amortized over the next eight years; and
- Wisconsin Electric will continue to receive AFUDC on 100% of CWIP for the environmental control projects at its Oak Creek Power Plant and at Edgewater Generating Unit 5, and on Glacier Hills Wind Park.

#### 2010 Michigan Rate Increase Request:

In July 2009, Wisconsin Electric filed a \$42 million rate increase request with the MPSC, primarily to recover the costs of PTF projects. Michigan law allows utilities, upon the satisfaction of certain conditions, to self implement a rate increase request, subject to refund with interest. In December 2009, the MPSC approved Wisconsin Electric's modified self-implementation plan to increase electric rates in Michigan by approximately \$12 million (9.5%), effective upon commercial operation of OC 1, which occurred on February 2, 2010. This rate increase is subject to refund with interest, depending upon the MPSC's final decision on Wisconsin Electric's \$42 million rate request, which is expected in July 2010.

#### 2008 Wisconsin Rate Increase

: During 2007, Wisconsin Electric and Wisconsin Gas initiated rate proceedings. On January 17, 2008, the PSCW approved pricing increases for Wisconsin Electric and Wisconsin Gas as follows:

- ◆ \$389.1 million (17.2%) in electric rates for Wisconsin Electric - the pricing increase was offset by bill credits in 2008 and 2009;
- ◆ \$4.0 million (0.6%) for natural gas service from Wisconsin Electric;
- ◆ \$3.6 million (11.2%) for steam service from Wisconsin Electric; and
- ◆ \$20.1 million (2.2%) for natural gas service from Wisconsin Gas.

In addition, the PSCW lowered the return on equity for Wisconsin Electric and Wisconsin Gas from 11.2% to 10.75%. The PSCW also determined that \$85.0 million of the Point Beach proceeds should be immediately applied to offset certain regulatory assets.

#### 2008 Michigan Rate Increase

: In January, 2008, Wisconsin Electric filed a rate increase request with the MPSC. This request represented an increase in electric rates of 14.7%, or \$22.0 million, to support the growing demand for electricity, continued investment in renewable programs, compliance with environmental regulations, addition of distribution infrastructure and increased operational expenses. In November 2008, a settlement agreement

with the MPSC staff and intervenors for a rate increase of \$7.2 million, or 4.6%, was approved by the MPSC, effective January 1, 2009.

### Limited Rate Adjustment Requests

#### 2010 Fuel Recovery Request:

On February 19, 2010, Wisconsin Electric filed a \$60.5 million rate increase request with the PSCW to recover forecasted increases in fuel and purchased power costs. The increase in fuel and purchased power costs is being driven primarily by increases in the price of natural gas, changes in the timing of plant outages and increased MISO costs. We expect to implement this rate request by the end of the first quarter of

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2010, subject to refund based upon the PSCW's final decision. The ultimate rate increase will be subject to the review and approval of the PSCW, which we expect to receive by the end of 2010.

#### 2009 Fuel Cost Decrease Filing:

Wisconsin Electric operates under a fuel cost adjustment clause for fuel and purchased power costs associated with the generation and delivery of electricity to its retail customers in Wisconsin. In April 2009, based on three months of actual fuel cost data and nine months of projected data, Wisconsin Electric forecasted that its monitored fuel cost for 2009 would fall outside the range prescribed by the PSCW and would be less than the monitored fuel cost reflected in then authorized rates. Therefore, in April 2009, Wisconsin Electric filed a request with the PSCW to decrease annual Wisconsin retail electric rates by \$67.2 million for calendar year 2009. On April 30, 2009, the PSCW approved the fuel cost decrease filing with rates effective May 1, 2009.

#### 2008 Fuel Recovery Request:

In March 2008, Wisconsin Electric filed a rate increase request with the PSCW to recover forecasted increases in fuel and purchased power costs. The increase in fuel costs was being driven primarily by increases in the price of natural gas and the higher cost of transporting coal by rail as a result of increases in the cost of diesel fuel. On April 11, 2008, the PSCW approved an annual increase of \$76.9 million (3.3%) in Wisconsin retail electric rates on an interim basis. In July 2008, we received the final rate order, which authorized an additional \$42.0 million in rate increases, for a total increase of \$118.9 million (5.1%). Any over-collection of fuel surcharge revenue in calendar year 2008 was subject to refund with interest at a rate of 10.75%. In April 2009, the PSCW ordered that we should refund \$8.8 million (including interest) of over-collected fuel surcharge revenue. The refund was issued during the second quarter of 2009.

### Other Utility Rate Matters

#### Oak Creek Air Quality Control System Approval:

In July 2008, we received approval from the PSCW granting Wisconsin Electric authority to construct wet flue gas desulfurization and selective catalytic reduction facilities at Oak Creek Power Plant units 5-8. Construction of these emission controls began in late July 2008, and we expect the installation to be completed during 2012. We currently expect the cost of completing this project to be approximately \$800 million (\$950 million including AFUDC). The cost of constructing these facilities has been included in our previous estimates of the costs to implement the Consent Decree with the EPA.

#### Michigan Legislation:

During October 2008, Michigan enacted legislation to make significant changes in regulatory procedures, which should provide for more timely cost recovery. Public Act 286 allows the use of a forward-looking test year in rate cases rather than historical data, and allows us to put interim rates into effect six months after filing a complete case. Rate filings for which an order is not issued within 12 months are deemed approved. In addition, we could seek a CPCN for new investment, and could recover interest on the investment during construction. Public Act 286 also gives the MPSC expanded authority over proposed mergers and acquisitions, and requires action within 180 days of filing. In addition, Public Act 295 calls for the implementation of a renewable portfolio standard of 10% by 2015, and energy optimization (efficiency) targets up to 1% annually by 2015. Public Act 295 specifically calls for current recovery of costs incurred to meet the standards, and provides for ongoing review and revision to assure the measures taken are cost-effective.

#### Fuel Cost Adjustment Procedure:

Within the state of Wisconsin, Wisconsin Electric operates under a fuel cost adjustment clause for fuel and purchased power costs associated with the generation and delivery of electricity and purchase power contracts. Embedded within its base rates is an amount to recover fuel costs. Under the current fuel rules, no adjustments are made to rates as long as fuel and purchased power costs are expected to be within a band of the costs embedded in current rates for the 12-month period ending December 31. If, however, annual fuel costs are expected to fall outside of the band, and actual costs fall outside of established fuel bands, then we may file for a change in fuel recoveries on a prospective basis.

In June 2006, the PSCW opened a docket (01-AC-224) to consider revisions to the existing fuel rules (Chapter PSC 116). The current version of the revised rule recommends modifications to allow for annual plan and reconciliation filings of fuel costs by each regulated utility. In the period between plan and reconciliation, escrow accounting would be used to record fuel costs outside a plus or minus 2% annual band of the total fuel costs allowed in rates. The proposed rule further recommends that the escrow balance be trued-up annually following the end of each calendar year. Currently, draft legislation is under review. The earliest that we expect any possible action on the fuel rules is mid-2010.

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Edison Sault and Wisconsin Electric's operations in Michigan operate under a Power Supply Cost Recovery mechanism which generally allows for the recovery of fuel and purchased power costs on a dollar for dollar basis.

#### Electric Transmission Cost Recovery:

Wisconsin Electric divested its transmission assets with the formation of ATC in January 2001. We now procure transmission service from ATC at FERC approved tariff rates. In connection with the formation of ATC, our transmission costs have escalated due to the socialization of costs within ATC and increased transmission infrastructure requirements in the state. In 2002, in connection with the increased costs experienced by our customers, the PSCW issued an order which allowed us to use escrow accounting whereby we deferred transmission costs that exceeded amounts embedded in our rates. We were allowed to earn a return on the unrecovered transmission costs we deferred at our weighted average cost of capital. As of December 31, 2009, we had deferred \$157.8 million of unrecovered transmission costs. The escrow accounting treatment has been discontinued as our 2008 and 2010 PSCW rate orders have provided for recovery of these costs.

#### Gas Cost Recovery Mechanism:

Our natural gas operations operate under GCRMs as approved by the PSCW. Generally, the GCRMs allow for a dollar for dollar recovery of gas costs. Prior to 2010, there was an incentive mechanism under the GCRMs that allowed for increased revenues if we acquired gas at prices lower than benchmarks approved by the PSCW. However, as part of the January 2010 PSCW rate order, the PSCW approved changing from an incentive method to a modified one for one method. The new method does not have revenue sharing. The GCRMs measure commodity purchase costs against a monthly benchmark which includes a 2% tolerance. Costs in excess of this monthly benchmark are subject to additional review by the PSCW before they can be passed through to our customers. The modified one for one is the same method used by the other utilities in Wisconsin.

#### Bad Debt Costs:

In March 2005, the PSCW approved our use of escrow accounting for residential bad debt costs. The escrow method of accounting for bad debt costs allows for deferral of Wisconsin residential bad debt expense that exceeds amounts allowed in rates. As part of the January 2010 PSCW rate order, the escrow accounting method for bad debt costs was extended through December 31, 2011.

#### MISO Energy Markets:

The PSCW approved deferral treatment for our costs related to the implementation of the MISO Energy Markets. Amounts deferred through December 31, 2007 are being recovered in rates. For additional information, see Industry Restructuring and Competition -- Electric Transmission and Energy Markets.

### Wholesale Electric Pricing:

In August 2006, Wisconsin Electric filed a wholesale rate case with FERC. The filing requested an annual increase in rates of approximately \$16.7 million applicable to four existing wholesale electric customers. This includes a mechanism for fuel and other cost adjustments. In November 2006, FERC approved the rate filing subject to refund with interest. Three of the existing customers' rates were effective in January 2007. The remaining wholesale customer's rates were effective in May 2007. FERC approved a settlement of the rate filing in September 2007. In August 2008, we issued a one-time \$62.5 million refund to our wholesale customers pursuant to a FERC-approved settlement related to the sale of Point Beach.

### Depreciation Rates:

In January 2009, we filed a depreciation study with the PSCW, proposing new depreciation rates that would reduce annual depreciation expense by approximately \$55 million. The PSCW approved the depreciation study and the new depreciation rates began on January 1, 2010. We do not expect the new depreciation rates to have a material impact on earnings because the new depreciation rates were considered when the PSCW set our 2010 electric and gas rates.

### Renewables, Efficiency and Conservation:

In March 2006, Wisconsin revised the requirements for renewable energy generation by enacting Act 141. Act 141 defines "baseline renewable percentage" as the average of an energy provider's renewable energy percentage for 2001, 2002 and 2003. A utility's renewable energy percentage is equal to the amount of its total retail energy sales that are provided by renewable sources. Wisconsin Electric's baseline renewable energy percentage is 2.27%. Under Act 141, Wisconsin Electric could not decrease its renewable energy percentage for the years 2006-2009, and for the years 2010-2014, it must increase its renewable energy percentage at least two percentage points to a level of 4.27%. Act 141 further requires that for the year 2015 and beyond, the renewable energy percentage must increase at least six percentage points above the baseline to a level of 8.27%. Act 141 establishes a goal that 10% of all electricity consumed in Wisconsin be generated by renewable resources by December 31, 2015. Assuming the bulk of additional renewables is wind generation, Wisconsin Electric must obtain approximately 362 MW of additional renewable capacity by 2012 and another approximately 300 MW of additional renewable capacity by 2015 to meet the requirements of Act 141. We have

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already started development of additional sources of renewable energy which will assist us in complying with Act 141. See Renewable Energy Portfolio discussion below.

In 2007, the Governor of Wisconsin established the Governor's Task Force on Global Warming. The Task Force issued its final report in July 2008 that includes an increased renewable portfolio standard. Pursuant to the Task Force's recommendations, the renewable portfolio standard would increase to 10% by 2013, 20% by 2020 and 25% by 2025. Draft legislation regarding this recommendation, as well as other recommendations made by the Task Force, is pending in the Wisconsin legislature

Act 141 allows the PSCW to delay a utility's implementation of the renewable portfolio standard if it finds that achieving the renewable requirement would result in unreasonable rate increases or would lessen reliability, or that new renewable projects could not be permitted on a timely basis or could not be served by adequate transmission facilities. Act 141 provides that if a utility is in compliance with the renewable energy and energy efficiency requirements as determined by the PSCW, then the utility may not be ordered to achieve additional energy conservation or efficiency. Prior to Act 141, there had been no agreement on how to determine compliance with the Energy Priorities law, which provides that it is the policy of the PSCW, to the extent it is cost-effective and technically feasible, to consider the following options in the listed order when reviewing energy-related applications: (1) energy conservation and efficiency, (2) noncombustible renewable energy resources, (3) combustible renewable energy resources,

(4) natural gas, (5) oil or low sulfur coal and (6) high sulfur coal and other carbon-based fuels.

Act 141 also redirects the administration of energy efficiency, conservation and renewable programs from the DOA back to the PSCW and/or contracted third parties. In addition, Act 141 requires that 1.2% of utilities' annual operating revenues be used to fund these programs. The Governor of Wisconsin's Task Force on Global Warming recommended in July 2008 that the energy efficiency goal be based on achieving efficiency resulting in a 2% reduction in electric load annually starting in 2015 rather than a goal based on a percent of revenue.

Public Act 295 enacted in Michigan calls for the implementation of a renewable portfolio standard by 2015 and energy optimization (efficiency) targets up to 1% annually by 2015. Public Act 295 specifically calls for current recovery of costs incurred to meet the standards and provides for ongoing review and revision to assure the measures taken are cost-effective.

#### Renewable Energy Portfolio:

In May 2008, the Blue Sky Green Field wind farm project, which has 88 turbines with an installed capacity of 145 MW, reached commercial operation. In July 2008, we completed the purchase of rights to a new wind farm site in Central Wisconsin, Glacier Hills Wind Park, and filed a request for a CPCN with the PSCW in October 2008. We entered into a conditional turbine agreement for the new wind facility and filed a revised, lower cost estimate with the PSCW in May 2009 of \$335.2 million to \$413.5 million, excluding AFUDC. The PSCW approved the CPCN in January 2010. We currently expect to install up to 90 wind turbines with generating capacity of up to approximately 207 MW, subject to turbine selection and the final site configuration. We expect 2012 to be the first full year of operation.

In September 2009, we announced plans to construct a biomass-fueled power plant at Domtar Corporation's Rothschild, Wisconsin paper mill site. Wood, waste and sawdust will be used to produce approximately 50 MW of electricity and will also support Domtar's sustainable papermaking operations. We believe

the biomass plant will be eligible for either the federal production tax credit or the federal 30% investment tax credit. We currently expect the plant to cost approximately \$250 million and to be completed during the fall of 2013, subject to regulatory approvals. We expect to file a request for a Certificate of Authority for the project in the first quarter of 2010.

#### ELECTRIC SYSTEM RELIABILITY

In response to customer demand for higher quality power required by modern equipment, we are evaluating and updating our electric distribution system. We are taking steps to reduce the likelihood of outages by upgrading substations and rebuilding lines to upgrade voltages and reliability. These improvements, along with better technology for analysis of our existing system, better resource management to speed restoration and improved customer communication, are near-term efforts to enhance our current electric distribution infrastructure. For the long-term, we have developed a distribution system asset management strategy that requires increased levels of automation of both substations and line equipment to consistently provide the level of reliability needed for a digital economy.

We had adequate capacity to meet all of our firm electric load obligations during 2009 and 2008. All of our generating plants performed well during the warmest periods of the summer and all power purchase commitments under firm contract were received. During this period, public appeals for conservation were not required and we did not interrupt or curtail service to non-firm customers who participate in load management programs. We expect to have adequate capacity to meet all of our firm load obligations during 2010. However, extremely hot weather, unexpected equipment failure or unavailability could require us to call upon load management procedures.

## ENVIRONMENTAL MATTERS

Consistent with other companies in the energy industry, we face significant ongoing environmental compliance and remediation obligations related to current and past operations. Specific environmental issues affecting our utility and non-utility energy segments include but are not limited to current and future regulation of: (1) air emissions such as CO<sub>2</sub>, SO<sub>2</sub>, NO<sub>x</sub>, fine particulates and mercury; (2) disposal of combustion by-products such as fly ash; and (3) remediation of impacted properties, including former manufactured gas plant sites.

We are currently pursuing a proactive strategy to manage our environmental compliance obligations, including: (1) improving our overall energy portfolio by adding more efficient generation as part of our PTF strategy; (2) developing additional sources of renewable electric energy supply; (3) reviewing water quality matters such as discharge limits and cooling water requirements; (4) adding emission control equipment to existing facilities to comply with new ambient air quality standards and federal clean air rules; (5) implementing a Consent Decree with the EPA to reduce emissions of SO<sub>2</sub> and NO<sub>x</sub> by more than 65% by 2013; (6) evaluating and implementing improvements to our cooling water intake systems; (7) continuing the beneficial re-use of ash and other solid products from coal-fired generating units; and (8) conducting the clean-up of former manufactured gas plant sites. The capital cost of implementing the EPA Consent Decree is estimated to be approximately \$1.2 billion over the 10 year period ending 2013. These costs are principally associated with the installation of air quality controls on Pleasant Prairie Units 1 and 2 and Oak Creek Units 5-8. In June 2007, we submitted an application to the PSCW requesting approval to construct environmental controls at Oak Creek Units 5-8 by 2012 as required by the Consent Decree. We expect the cost of completing this project to be approximately \$800 million, excluding AFUDC. Through December 31, 2009, we have spent approximately \$686 million associated with the installation of air quality controls and have retired four coal units as part of our plan under the Consent Decree. For further information concerning the Consent Decree, see Note S -- Commitments and Contingencies in the Notes to Consolidated Financial Statements in this report.

### Air Quality:

#### 8-hour Ozone Standard:

In April 2004, the EPA designated 10 counties in southeastern Wisconsin as non-attainment areas for the 8-hour ozone ambient air quality standard. States were required to develop and submit SIPs to the EPA by June 2007 to demonstrate how they intended to comply with the 8-hour ozone ambient air quality standard. Instead of submitting a SIP, Wisconsin submitted a request to redesignate all counties in southeastern Wisconsin as in attainment with the standard. In addition to the request for redesignation, Wisconsin also adopted the RACT rule that applies to emissions from our power plants in the affected areas of Wisconsin. Compliance with the NO<sub>x</sub> emission reduction requirements under the Consent Decree has substantially mitigated costs to comply with the RACT rule. In March 2008, the EPA issued a determination that the state of Wisconsin had failed to submit a SIP. In July 2009, Wisconsin issued both a draft Attainment Demonstration and a Redesignation request. Based on our review of these drafts, we do not believe we would be subject to any further requirements to reduce emissions. The EPA must take final approval action once Wisconsin finalizes its submittals.

In March 2008, the EPA announced its decision to further lower the 8-hour ozone standard, and in January 2010, the EPA proposed to lower that standard further. Given this most recent revision, the EPA has delayed the deadline for new non-attainment area designations under the revised standard once it is finalized, from March 2010 to March 2011. Although it is likely that additional counties may be designated as non-attainment areas under the revised standard, until those designations become final and until any potential additional rules are adopted, we are unable to predict the impact on the operation of our existing coal-fired generation facilities.

#### Fine Particulate Standard:

In December 2004, the EPA designated PM<sub>2.5</sub> non-attainment areas. All counties in Wisconsin and all counties in the Upper Peninsula of Michigan were designated as in attainment with the standard. In December 2006, a more restrictive federal standard became effective; however, on February 24, 2009 the D.C.

Circuit Court of Appeals issued a decision on the revised standard and remanded it back to the EPA for revision. The Court's decision will likely result in an even more stringent annual PM<sub>2.5</sub> standard. In October 2009, the EPA designated three counties in southeast Wisconsin (Milwaukee, Waukesha and Racine) as not meeting the 2006 daily standard for PM<sub>2.5</sub>. Wisconsin will now have three years to develop a SIP and submit it to the EPA for approval, and will need to implement actions to reach attainment in the 2014-2019 time period. The impact of future SIP requirements cannot be determined at this time. Similarly, until the EPA revises the 2006 standard consistent with the court's decision and the states develop rules and submit SIPs to the EPA to demonstrate how they intend to comply with that standard, we are unable to predict the impact of this more restrictive standard on the operation of our existing coal-fired generation facilities or our new PTF generating units being leased by Wisconsin Electric including OC 1, OC 2, PWGS 1 and PWGS 2.

In a related matter, on February 11, 2010, the EPA announced its intent to end the transitional policy which has allowed facilities to use in their air permits PM<sub>10</sub> (an earlier measure of particulate matter) as a surrogate when measuring PM<sub>2.5</sub> emissions. This policy had allowed both the agencies and permit holders to continue to use standards that were well established, until the EPA and the states developed the necessary tools for permitting PM<sub>2.5</sub> emissions. The discontinuation of this policy creates uncertainty as to how this parameter will be evaluated when we seek and maintain Title V air permits for our facilities. The EPA will be taking written comments on the rule and until the rule is finalized, we are not able to predict the impact of this policy change on our operations.

#### Sulfur Dioxide Standard:

The EPA is currently in the process of revising the ambient air quality standard for SO<sub>2</sub>. In November 2009, the EPA proposed to strengthen the primary standard for SO<sub>2</sub> by revoking the current standards and replacing them with a more stringent one-hour SO<sub>2</sub> standard. If the revised standard ultimately selected results in the designation of new non-attainment areas, it could potentially have an adverse effect on our facilities in those areas.

#### Clean Air Interstate Rule:

The EPA issued the final CAIR in March 2005 to facilitate the states in meeting the 8-hour ozone and PM<sub>2.5</sub> standards by addressing the regional transport of SO<sub>2</sub> and NO<sub>x</sub>. CAIR required NO<sub>x</sub> and SO<sub>2</sub> emission reductions in two phases from electric generating units located in a 28-state region within the eastern United States, including Wisconsin and Michigan. Overall, CAIR is expected to result in a 70% reduction in SO<sub>2</sub> emissions and a 65% reduction in NO<sub>x</sub> emissions from 2002 emission levels. A final CAIR rule was adopted in Wisconsin and Michigan. In 2008, the U.S. Court of Appeals for the D.C. Circuit invalidated several aspects of CAIR and remanded the rule to the EPA to promulgate a replacement rule. We previously determined that compliance with the NO<sub>x</sub> and SO<sub>2</sub> emission reductions requirements under the Consent Decree would substantially mitigate costs to comply with CAIR and would achieve the levels necessary under at least the first phase of CAIR. It will be necessary to see what the revised rule contains before we can determine if any additional reductions will be required.

#### Mercury and Other Hazardous Air Pollutants:

The EPA issued the final CAMR in March 2005, addressing mercury emissions from new and existing coal-fired power plants. The federal rule was challenged by a number of states including Wisconsin and Michigan. In February 2008, the U.S. Court of Appeals for the D.C. Circuit vacated CAMR and sent the rule back to the EPA for reconsideration.

In December 2008, a

number of environmental groups filed a complaint with the D.C. Circuit asking that the court place the EPA on a schedule for promulgating MACT limits for fossil-fuel fired electric utilities to address hazardous air pollutants, including mercury. In October 2009, the EPA published notice of a proposed consent decree in connection with this litigation that would place the EPA on a schedule to set a MACT rule for coal and oil-fired electric generating units in 2011. The EPA is currently in the process of developing the proposed MACT rule which is expected to reduce emissions of numerous hazardous air pollutants, including mercury.



#### Wisconsin and Michigan State Only Mercury Rules:

Both Wisconsin and Michigan now have mercury rules in place. Both states require a 90% reduction of mercury. We have plans in place to comply with those requirements and the costs of these plans are incorporated into our capital and operation and maintenance costs.

#### Clean Air Visibility Rule:

The EPA issued CAVR in June 2005 to address Regional Haze, or regionally-impaired visibility caused by multiple sources over a wide area. The rule defines BART requirements for electric generating units and how BART will be addressed in the 28 states subject to EPA's CAIR. The pollutants from power plants that reduce visibility include PM<sub>2.5</sub> or compounds that contribute to fine particulate formation, NO<sub>x</sub>, SO<sub>2</sub> and ammonia. States were required to submit SIPs to implement CAVR by December 2007. Wisconsin has not yet

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submitted a SIP. Michigan submitted a SIP, which was partially approved. In response to a citizen suit, in January 2009, the EPA issued a finding of failure to 37 states, including Wisconsin and Michigan, regarding their failure to submit SIPs. The finding starts a two-year review window for the EPA to issue Federal Implementation Plans, unless a state submits and receives SIP approval.

Wisconsin and Michigan have completed the BART rules, which cover one aspect of CAVR regulations. Wisconsin BART rules became effective in July 2008 and Michigan BART rules became effective in September 2008.

Both Wisconsin and Michigan BART rules are based, in part, on utility reductions of NO<sub>x</sub> and SO<sub>2</sub> that were expected to occur under CAIR. Therefore, we will not be able to determine final impacts of these rules until the EPA completes a new CAIR rule pursuant to a ruling by the U.S. Court of Appeals for the D.C. Circuit requiring it to do so.

#### EPA Consent Decree:

In April 2003, Wisconsin Electric reached a Consent Decree with the EPA, in which it agreed to significantly reduce air emissions from certain of its coal-fired generating facilities. The U.S. District Court for the Eastern District of Wisconsin approved the amended Consent Decree and entered it in October 2007. For further information, see Note S -- Commitments and Contingencies in the Notes to Consolidated Financial Statements.

#### Climate Change:

We continue to take measures to reduce our emissions of greenhouse gases. We support flexible, market-based strategies to curb greenhouse gas emissions, including emissions trading, joint implementation projects and credit for early actions. We support a voluntary approach that encourages technology development and transfer and includes all sectors of the economy and all significant global emitters. Our emissions in future years will continue to be influenced by several actions completed, planned or underway, including:

- Repowering the Port Washington Power Plant from coal to natural gas-fired combined cycle units.
- Adding coal-fired units as part of the Oak Creek expansion that will be the most thermally efficient coal units in our system.
- Increasing investment in energy efficiency and conservation.
- Adding renewable capacity and promoting increased participation in the Energy for Tomorrow® renewable energy program.
- Retirement of Coal units 1-4 at the Presque Isle Power Plant.

Federal, state, regional and international authorities have undertaken efforts to limit greenhouse gas emissions. Legislative proposals that would impose mandatory restrictions on CO<sub>2</sub> emissions continue to be considered in the U.S. Congress, and the President and his administration have made it clear that they are focused on reducing CO<sub>2</sub> emissions, through legislation and/or regulation. Although the ultimate outcome of these efforts cannot be determined at this time, mandatory restrictions on our CO<sub>2</sub> emissions could result in significant compliance costs that could affect future results of operations, cash flows and financial condition. For additional information, see the caption "We may

face significant costs to comply with the regulation of greenhouse gas emissions." under Item 1A Risk Factors in this report.

#### Clean Water Act:

Section 316(b) of the CWA requires that the location, design, construction and capacity of cooling water intake structures reflect the BTA for minimizing adverse environmental impact. In September 2004, the EPA adopted rules for existing facilities to minimize the potential adverse impacts to aquatic organisms associated with water withdrawals from cooling water intakes. Costs associated with implementation of the 316(b) rules for Wisconsin Electric's Oak Creek Power Plant, We Power's Oak Creek expansion and PWGS were included in project costs.

In January 2007, the Federal Court of Appeals for the Second Circuit found certain portions of the rule impermissible, including portions that permitted approval of water intake system technologies based on a cost-benefit analysis, and remanded several parts of the rule to the EPA for further consideration or potential additional rulemaking. In April 2009, the United States Supreme Court reversed the Second Circuit regarding the use of cost-benefit analysis and held that it was permissible for the EPA to rely on cost-benefit analysis in setting national performance standards and in providing variances from those standards. The Supreme Court remanded the case for further proceedings consistent with its opinion.

Until the EPA completes its reconsideration and rulemaking, we cannot predict what impact these changes may have on our facilities. The decision will not affect the new units at the Oak Creek expansion, because those units were permitted based on a BTA decision under the Phase I rule for new facilities.

In addition, in December 2009, the EPA published its determination that revision of the current effluent guidelines for steam electric generating units was warranted, and proposed a rulemaking process to adopt such revisions by 2013. Revisions to the current effluent guidelines are expected to result in more stringent standards that may result in the installation of additional controls. Until the EPA completes its rulemaking process, however, we cannot predict what impact these new standards may have on our facilities.

#### Other Environmental Matters:

##### Manufactured Gas Plant Sites:

We are voluntarily reviewing and addressing environmental conditions at a number of former manufactured gas plant sites. For further information, see Note S -- Commitments and Contingencies in the Notes to Consolidated Financial Statements.

##### Ash Landfill Sites:

We aggressively seek environmentally acceptable, beneficial uses for our combustion byproducts. For further information, see Note S -- Commitments and Contingencies in the Notes to Consolidated Financial Statements.

## LEGAL MATTERS

#### Cash Balance Pension Plan:

## Edgar Filing: WISCONSIN ENERGY CORP - Form 10-K

On June 30, 2009, a lawsuit was filed by a former employee, against the Plan in the U.S. District Court for the Eastern District of Wisconsin. Counsel representing the plaintiff is attempting to seek class certification for other similarly situated plaintiffs. The complaint alleges that Plan participants who received a lump sum distribution under the Plan prior to their normal retirement age did not receive the full benefit to which they were entitled in violation of ERISA and are owed additional benefits, because the Plan failed to apply the correct interest crediting rate to project the cash balance account to their normal retirement age. We believe the Plan correctly calculated the lump-sum distributions. An adverse outcome of this lawsuit could affect our Plan funding and expense. We are currently unable to predict the final outcome or impact of this litigation.

### Settlement with the Mines:

In May 2007, Wisconsin Electric entered into a settlement agreement with our largest customers, two iron ore mines, related to an arbitration proceeding over disputed billings arising from the special negotiated contracts the mines operated under until they expired in December 2007. The settlement was a full and complete resolution of all claims and disputes between the parties for electric service rendered by Wisconsin Electric under the power purchase agreements through March 31, 2007. Pursuant to the settlement, the mines paid Wisconsin Electric approximately \$9.0 million and Wisconsin Electric released to the mines all funds it was holding in escrow. The estimated earnings impact of the payment from the mines was \$0.04 per share, which was recorded in 2007. Beginning in January 2008, the mines began receiving electric service from Wisconsin Electric in accordance with tariffs approved by the MPSC.

### Stray Voltage:

On July 11, 1996, the PSCW issued a final order regarding the stray voltage policies of Wisconsin's investor-owned utilities. The order clarified the definition of stray voltage, affirmed the level at which utility action is required, and placed some of the responsibility for this issue in the hands of the customer. Additionally, the order established a uniform stray voltage tariff which delineates utility responsibility and provides for the recovery of costs associated with unnecessary customer demanded services.

In recent years, dairy farmers have commenced actions or made claims against Wisconsin Electric for loss of milk production and other damages to livestock allegedly caused by stray voltage and ground currents resulting from the operation of its electrical system, even though that electrical system has been operated within the parameters of the PSCW's order. The Wisconsin Supreme Court has rejected the arguments that, if a utility company's measurement of stray voltage is below the PSCW "level of concern," that utility could not be found negligent in stray voltage cases. Additionally, the Court has held that the PSCW regulations regarding stray voltage were only minimum standards to be considered by a jury in stray voltage litigation. As a result of this case, claims by dairy farmers for livestock damage have been based upon ground currents with levels measuring less than the PSCW "level of concern."

In December 2008, a stray voltage lawsuit was filed against Wisconsin Electric. We do not believe the lawsuit has merit and we will vigorously defend the case. This lawsuit is not expected to have a material adverse effect on our financial statements. In June 2007, another stray voltage lawsuit was settled. This settlement did not have a material adverse effect on our financial condition or results of operations. We continue to evaluate various options and strategies to mitigate this risk.

## NUCLEAR OPERATIONS

### Point Beach Nuclear Plant:

Wisconsin Electric previously owned two electric generating units (Unit 1 and Unit 2) at Point Beach in Two Rivers, Wisconsin. In September 2007, Wisconsin Electric sold Point Beach to an affiliate of FPL for approximately \$924 million. For additional information on this sale, see Corporate Strategy at the beginning of Management's Discussion and Analysis of Financial Condition and Results of Operations. A

long-term power purchase agreement with the buyer became effective upon closing of the sale. Pursuant to this agreement, Wisconsin Electric is purchasing all of the energy produced by Point Beach. The power purchase agreement extends through 2030 for Unit 1 and 2033 for Unit 2. Based on the agreement, we are paying a pre-determined price per MWh for energy delivered according to a schedule that is established in the agreement. Under the agreement, if our credit rating and the credit rating of Wisconsin Electric from either S&P or Moody's fall below investment grade, or if the holders of any indebtedness in excess of \$100.0 million accelerate or have the right to accelerate the maturity of such indebtedness as a result of a default, we would need to provide collateral in the amount of \$100.0 million (escalating at 3% per year commencing in 2024).

#### Used Nuclear Fuel Storage and Disposal:

During Wisconsin Electric's ownership of Point Beach, Wisconsin Electric was authorized by the PSCW to load and store sufficient dry fuel storage containers to allow Point Beach Units 1 and 2 to operate to the end of their original operating licenses, but not to exceed the original 48-canister capacity of the dry fuel storage facility. The original operating licenses were set to expire in October 2010 for Unit 1 and in March 2013 for Unit 2 before they were renewed and extended by the NRC in December 2005.

Temporary storage alternatives at Point Beach are necessary until the DOE takes ownership of and permanently removes the used fuel as mandated by the Nuclear Waste Policy Act of 1982, as amended in 1987. The Nuclear Waste Policy Act established the Nuclear Waste Fund which is composed of payments made by the generators and owners of such waste and fuel. Effective January 31, 1998, the DOE failed to meet its contractual obligation to begin removing used fuel from Point Beach, a responsibility for which Wisconsin Electric paid a total of \$215.2 million into the Nuclear Waste Fund over the life of its ownership of Point Beach.

In August 2000, the United States Court of Appeals for the Federal Circuit ruled in a lawsuit brought by Maine Yankee and Northern States Power Company that the DOE's failure to begin performance by January 31, 1998 constituted a breach of the Standard Contract, providing clear grounds for filing complaints in the Court of Federal Claims. Consequently, Wisconsin Electric filed a complaint in November 2000 against the DOE in the Court of Federal Claims. In October 2004, the Court of Federal Claims granted Wisconsin Electric's motion for summary judgment on liability. The Court held a trial during September and October 2007 to determine damages. In December 2009, the Court ruled in favor of Wisconsin Electric, granting us more than \$50 million in damages. We anticipate that the DOE will appeal this decision, and that any recoveries will be included in future rate cases.

## INDUSTRY RESTRUCTURING AND COMPETITION

### Electric Utility Industry

The regulated energy industry continues to experience significant changes. FERC continues to support large RTOs, which will affect the structure of the wholesale market. To this end, the MISO implemented bid-based markets, the MISO Energy Markets, including the use of LMP to value electric transmission congestion and losses. The MISO Energy Markets commenced operation in April 2005 for energy distribution and in January 2009 for operating reserves. Increased competition in the retail and wholesale markets, which may result from restructuring efforts, could have a significant and adverse financial impact on us. It is uncertain when retail access might be implemented, if at all, in Wisconsin; however, Michigan has adopted retail choice which potentially affects our Michigan operations. The Energy Policy Act, among other things, amended federal energy laws and provided FERC with new oversight responsibilities.

### Restructuring in Wisconsin:

Electric utility revenues in Wisconsin are regulated by the PSCW. Due to many factors, including relatively competitive electric rates charged by the state's electric utilities, the PSCW has been focused on electric reliability infrastructure issues for the state of Wisconsin in recent years. These issues include:

- Addition of generating capacity in the state;
- Modifications to the regulatory process to facilitate development of merchant generating plants;
- Development of a regional independent electric transmission system operator;
- Improvements to existing and addition of new electric transmission lines in the state; and
- Addition of renewable generation.

The PSCW continues to maintain the position that the question of whether to implement electric retail competition in Wisconsin should ultimately be decided by the Wisconsin legislature. No such legislation has been introduced in Wisconsin to date.

### Restructuring in Michigan:

Our Michigan retail customers are allowed to remain with their regulated utility at regulated rates or choose an alternative electric supplier to provide power supply service. We have maintained our generation capacity and distribution assets and provide regulated service as we have in the past. We continue providing distribution and customer service functions regardless of the customer's power supplier.

Competition and customer switching to alternative suppliers in our service territories in Michigan has been limited. With the exception of general inquiries, no alternate supplier activity has occurred in our service territories in Michigan. We believe that this lack of alternate supplier activity reflects our small market area in Michigan, our competitive regulated power supply prices and a general lack of interest in the Upper Peninsula of Michigan as a market for alternative electric suppliers.

### Electric Transmission and Energy Markets

In connection with its status as a FERC approved RTO, MISO developed bid-based energy markets, which were implemented on April 1, 2005. In January 2009, MISO commenced the Energy and Operating Reserves Markets, which includes the bid-based energy markets and a relatively new ancillary services market. We previously self-provided both regulation reserves and contingency reserves. In the MISO ancillary services market, we buy/sell regulation and contingency reserves from/to the market. The MISO ancillary services market has been able to reduce overall ancillary services costs in the MISO footprint. The MISO ancillary services market has enabled MISO to assume significant balancing area responsibilities such as frequency control and disturbance control

In MISO, base transmission costs are currently being paid by LSEs located in the service territories of each MISO transmission owner. In February 2008, FERC issued several orders confirming the use of the current transmission cost allocation methodology. In October 2009, FERC issued an order related to the allocation of costs for network transmission upgrades. As a condition of this order, MISO is expected to submit a filing by July 15, 2010 to replace the current cost allocation methodology.

In April 2006, FERC issued an order determining that MISO had not applied its energy markets tariff correctly in the assessment of RSG charges. FERC ordered MISO to resettle all affected transactions retroactive to the commencement of the energy market. In October 2006 and March 2007, we received additional rulings from FERC on these issues. FERC's rulings have been challenged by MISO and numerous other market participants. In July 2007, MISO commenced with the resettlement of the market in response to the orders. The resettlement was completed in January 2008 and resulted in a net cost increase of \$7.8 million to us. Several entities filed formal complaints with

FERC on the assessment of these charges. We filed in support of these complaints.

In November 2007, FERC issued another RSG order related to the rehearing requests previously filed. This order provided a clarification that was contrary to how MISO implemented the last resettlement. Once again, several parties, including Wisconsin Electric, filed for rehearing and/or clarification with FERC.

In addition, FERC ruled on the formal complaints filed by other entities in August 2007. FERC ruled that the current RSG cost allocation methodology may be unjust and unreasonable and established a refund effective date of August 10, 2007. MISO was ordered to file a new cost allocation methodology by March 2008. MISO filed new tariff language which indicated the new cost allocation methodology cannot be applied retroactively. We extended our previous rehearing/clarification request to include the timeframe from the established refund date through

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March 2008. In September 2008, FERC set a paper hearing for the formal complaints filed in 2007. FERC ruled on the outstanding rehearing/clarification requests and formal complaints in November 2008. FERC's ruling ordered the resettlements to begin from the date the MISO Energy Markets commenced in order to correct the RSG cost allocation methodology. Additionally, the order also set a new RSG cost allocation effective August 10, 2007. However, numerous entities filed rehearing requests in objection of these rulings. Although MISO requested a postponement of the resettlements until the matter is resolved, the resettlement commenced in March 2009.

In May 2009, FERC issued an order denying rehearing on substantive matters for the rate period beginning August 10, 2007. However, FERC modified the effective date of that rate to November 10, 2008, and ordered MISO to cease the ongoing resettlement and to reconcile all invoices and payments therein. Similarly, in June 2009, FERC dismissed rehearing requests, but waived refunds for the period April 25, 2006 through November 4, 2007. FERC also stated for the first time that it was waiving refunds for the period April 1, 2005 through April 24, 2006. We, along with others, have sought rehearing and/or appeal of the FERC's May and June 2009 determinations pertaining to refunds. In addition, there are contested compliance matters pending FERC review. The net effects of FERC's rulings are uncertain at this time.

As part of MISO, a market-based platform was developed for valuing transmission congestion premised upon the LMP system that has been implemented in certain northeastern and mid-Atlantic states. The LMP system includes the ability to mitigate or eliminate congestion costs through ARRs and FTRs. ARRs are allocated to market participants by MISO and FTRs are purchased through auctions. A new allocation and auction was completed for the period of June 1, 2009 through May 31, 2010. The resulting ARR valuation and the secured FTRs should adequately mitigate our transmission congestion risk for that period.

#### Natural Gas Utility Industry

#### Restructuring in Wisconsin:

The PSCW previously instituted generic proceedings to consider how its regulation of gas distribution utilities should change to reflect the changing competitive environment in the natural gas industry. To date, the PSCW has made a policy decision to deregulate the sale of natural gas in customer segments with workably competitive market choices and has adopted standards for transactions between a utility and its gas marketing affiliates. However, work on deregulation of the gas distribution industry by the PSCW is presently on hold. Currently, we are unable to predict the impact of potential future deregulation on our results of operations or financial position.

## ACCOUNTING DEVELOPMENTS

### New Pronouncements:

See Note B -- Recent Accounting Pronouncements in the Notes to Consolidated Financial Statements in this report for information on new accounting pronouncements.

### International Financial Reporting Standards:

During 2009, the SEC announced a "roadmap" for U.S. registrants that, if adopted, would require U.S. companies to follow IFRS instead of GAAP. The SEC guidelines, in their current form, would require us to adopt IFRS in 2014.

## CRITICAL ACCOUNTING ESTIMATES

Preparation of financial statements and related disclosures in compliance with GAAP requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. The application of these policies necessarily involves judgments regarding future events, including the likelihood of success of particular projects, legal and regulatory challenges and anticipated recovery of costs. These judgments, in and of themselves, could materially impact the financial statements and disclosures based on varying assumptions. In addition, the financial and operating environment may also have a significant effect, not only on the operation of our business, but on our results reported through the application of accounting measures used in preparing the financial statements and related disclosures, even if the nature of the accounting policies applied have not changed.

The following is a list of accounting policies that are most significant to the portrayal of our financial condition and results of operations and that require management's most difficult, subjective or complex judgments:

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### Regulatory Accounting:

Our utility subsidiaries operate under rates established by state and federal regulatory commissions which are designed to recover the cost of service and provide a reasonable return to investors. The actions of our regulators may allow us to defer costs that non-regulated entities would expense. The actions of our regulators may also require us to accrue liabilities that non-regulated companies would not. As of December 31, 2009, we had \$1,251.4 million in regulatory assets and \$1,109.5 million in regulatory liabilities. In the future, if we move to market based rates, or if the actions of our regulators change, we may conclude that we are unable to follow regulatory accounting. In this situation, continued deferral of certain regulatory asset and liability amounts on the utilities' books, as allowed under regulatory accounting, may no longer be appropriate and the unamortized regulatory assets net of the regulatory liabilities would be recorded as an extraordinary after-tax non-cash charge to earnings. We continually review the applicability of regulatory accounting and have determined that it is currently appropriate to continue following it. In addition, each quarter we perform a review of our regulatory assets and our regulatory environment and we evaluate whether we believe that it is probable that we will recover the regulatory assets in future rates. See Note C -- Regulatory Assets and Liabilities in the Notes to Consolidated Financial Statements for additional information.

### Pension and OPEB:

Our reported costs of providing non-contributory defined pension benefits (described in Note O -- Benefits in the Notes to Consolidated Financial Statements) are dependent upon numerous factors resulting from actual plan experience and assumptions of future experience. Pension costs are impacted by actual employee demographics (including age, compensation levels and employment periods), the level of contributions made to plans and earnings on plan assets. Changes made to the provisions of the plans may also impact current and future pension costs. Pension costs may also be significantly affected by changes in key actuarial assumptions, including anticipated rates of return on plan assets and

the discount rates used in determining the projected benefit obligation and pension costs.

Changes in pension obligations associated with these factors may not be immediately recognized as pension costs on the income statement, but generally are recognized in future years over the remaining average service period of plan participants. As such, significant portions of pension costs recorded in any period may not reflect the actual level of cash benefits provided to plan participants.

The following chart reflects pension plan sensitivities associated with changes in certain actuarial assumptions by the indicated percentage. Each sensitivity reflects a change to the given assumption, holding all other assumptions constant.

| Pension Plan<br>Actuarial Assumption                        | Impact on<br>Annual Cost |
|---|--------------------------|
|   | (Millions of Dollars)    |
| 0.5% decrease in discount rate and lump sum conversion rate | \$4.7                    |
| 0.5% decrease in expected rate of return on plan assets     | \$5.8                    |

In addition to pension plans, we maintain OPEB plans which provide health and life insurance benefits for retired employees (described in Note O -- Benefits in the Notes to Consolidated Financial Statements). Our reported costs of providing these post-retirement benefits are dependent upon numerous factors resulting from actual plan experience including employee demographics (age and compensation levels), our contributions to the plans, earnings on plan assets and health care cost trends. Changes made to the provisions of the plans may also impact current and future OPEB costs. OPEB costs may also be significantly affected by changes in key actuarial assumptions, including anticipated rates of return on plan assets and the discount rates used in determining the OPEB and post-retirement costs. Our OPEB plan assets are primarily made up of equity and fixed income investments. Fluctuations in actual equity market returns, as well as changes in general interest rates, may result in increased or decreased other post-retirement costs in future periods. Similar to accounting for pension plans, the regulators of our utility segment have adopted accounting guidance for compensation related to retirement benefits for rate-making purposes.

The following chart reflects OPEB plan sensitivities associated with changes in certain actuarial assumptions by the indicated percentage. Each sensitivity reflects a change to the given assumption, holding all other assumptions constant.

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| OPEB Plan<br>Actuarial Assumption                                | Impact on<br>Annual Cost |
|--|--------------------------|
|  | (Millions of<br>Dollars) |
| 0.5% decrease in discount rate                                   | \$2.3                    |
| 0.5% decrease in health care cost trend rate in all future years | (\$2.8)                  |



0.5% decrease in expected rate of return on plan assets \$1.0

#### Unbilled Revenues:

We record utility operating revenues when energy is delivered to our customers. However, the determination of energy sales to individual customers is based upon the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, amounts of energy delivered to customers since the date of their last meter reading are estimated and corresponding unbilled revenues are calculated. This unbilled revenue is estimated each month based upon actual generation and throughput volumes, recorded sales, estimated customer usage by class, weather factors, estimated line losses and applicable customer rates. Significant fluctuations in energy demand for the unbilled period or changes in the composition of customer classes could impact the accuracy of the unbilled revenue estimate. Total utility operating revenues during 2009 of approximately \$4.1 billion included accrued utility revenues of \$290.4 million as of December 31, 2009.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Factors Affecting Results, Liquidity and Capital Resources -- Market Risks and Other Significant Risks in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in this report for information concerning potential market risks to which Wisconsin Energy and its subsidiaries are exposed.

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#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

##### WISCONSIN ENERGY CORPORATION

##### CONSOLIDATED INCOME STATEMENTS

Year Ended December 31

2009

2008

2007

(Millions of Dollars, Except Per Share Amounts)

#### Operating Revenues

\$ 4,127.9

\$ 4,427.8

\$ 4,235.1

#### Operating Expenses

|  |         |
|--|---------|
| Fuel and purchased power                       | 1,063.7 |
|  | 1,240.7 |
|  | 996.4   |
| Cost of gas sold                               | 912.0   |
|  | 1,220.9 |
|  | 1,052.3 |
| Other operation and maintenance                | 1,261.1 |
|  | 1,360.4 |
|  | 1,134.6 |
| Depreciation, decommissioning and amortization | 346.1   |
|  | 326.5   |
|  | 327.9   |
| Property and revenue taxes                     | 112.0   |
|  | 108.2   |
|  | 103.2   |
| Total Operating Expenses                       | 3,694.9 |
|  | 4,256.7 |
|  | 3,614.4 |
| Amortization of Gain                           | 230.7   |
|  | 98      |

|  |       |
|--|-------|
|  | 488.1 |
|  | 6.5   |
| Operating Income                             |       |
|  | 663.7 |
|  | 659.2 |
|  | 627.2 |
| Equity in Earnings of Transmission Affiliate |       |
|  | 59.1  |
|  | 51.8  |
|  | 43.1  |
| Other Income and Deductions, net             |       |
|  | 28.4  |
|  | 17.0  |
|  | 48.9  |
| Interest Expense, net                        |       |
|  | 156.7 |
|  | 153.7 |
|  | 167.6 |
| Income from Continuing                       |       |
| Operations Before Income Taxes               |       |
|  | 594.5 |
|  | 574.3 |
|  | 551.6 |
| Income Taxes                                 |       |
|  | 217.3 |
|  | 216.5 |
|  | 99    |

|                                   |          |
|-----------------------------------|----------|
|                                   | 215.9    |
| Income from Continuing Operations |          |
|                                   | 377.2    |
|                                   | 357.8    |
|                                   | 335.7    |
| Income (Loss) from Discontinued   |          |
| Operations, Net of Tax            |          |
|                                   | 5.2      |
|                                   | 1.3      |
|                                   | (0.1)    |
| Net Income                        |          |
|                                   | \$ 382.4 |
|                                   | \$ 359.1 |
|                                   | \$ 335.6 |
| Earnings Per Share (Basic)        |          |
| Continuing Operations             |          |
|                                   | \$ 3.23  |
|                                   | \$ 3.06  |
|                                   | \$ 2.87  |
| Discontinued Operations           |          |
|                                   | 0.04     |
|                                   | 0.01     |
|                                   | -        |
| Total Earnings Per Share (Basic)  |          |
|                                   | \$ 3.27  |
|                                   | \$ 3.07  |
|                                   | 100      |

|   |    |       |
|---|----|-------|
|   | \$ | 2.87  |
| Earnings Per Share (Diluted)                          |    |       |
| Continuing Operations                                 |    |       |
|   | \$ | 3.20  |
|   | \$ | 3.03  |
|   | \$ | 2.83  |
| Discontinued Operations                               |    |       |
|   |    | 0.04  |
|   |    | 0.01  |
|   |    | -     |
| Total Earnings Per Share (Diluted)                    |    |       |
|   | \$ | 3.24  |
|   | \$ | 3.04  |
|   | \$ | 2.83  |
| Weighted Average Common Shares Outstanding (Millions) |    |       |
| Basic   |    |       |
|   |    | 116.9 |
|   |    | 116.9 |
|   |    | 116.9 |
| Diluted   |    |       |
|   |    | 117.9 |
|   |    | 118.2 |
|   |    | 118.5 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

WISCONSIN ENERGY CORPORATION  
CONSOLIDATED BALANCE SHEETS

December 31

ASSETS

|   | 2009                  | 2008       |
|---|-----------------------|------------|
|   | (Millions of Dollars) |            |
| Property, Plant and Equipment   |                       |            |
| In service  | \$ 10,286.6           | \$ 9,909.4 |
| Accumulated depreciation  | (3,472.2)             | (3,312.9)  |
|   | 6,814.4               | 6,596.5    |
| Construction work in progress   | 2,185.6               | 1,829.9    |
| Leased facilities, net  | 70.5                  | 76.2       |
| Net Property, Plant and Equipment   | 9,070.5               | 8,502.6    |
| Investments   |                       |            |
| Restricted cash   | -                     | 172.4      |
| Equity investment in transmission affiliate   | 314.6                 | 276.3      |
| Other   | 44.1                  | 41.6       |
| Total Investments   | 358.7                 | 490.3      |
| Current Assets  |                       |            |
| Cash and cash equivalents   | 20.9                  | 32.5       |
| Restricted cash   | 194.5                 | 214.1      |
| Accounts receivable, net of allowance for<br>doubtful accounts of \$57.9 and \$48.8 | 304.4                 | 369.5      |
| Accrued revenues  | 290.4                 | 341.2      |
| Materials, supplies and inventories   | 379.3                 | 344.7      |
| Regulatory assets   | 58.9                  | 82.5       |
| Prepayments and other   | 213.3                 | 323.0      |
| Total Current Assets  | 1,461.7               | 1,707.5    |

|   |                    |                    |
|---|--------------------|--------------------|
| Deferred Charges and Other Assets       |                    |                    |
| Regulatory assets                       | 1,192.5            | 1,261.1            |
| Goodwill                                | 441.9              | 441.9              |
| Other                                   | 172.6              | 214.4              |
| Total Deferred Charges and Other Assets | <u>1,807.0</u>     | <u>1,917.4</u>     |
| <br>                                    |                    |                    |
| Total Assets                            | <u>\$ 12,697.9</u> | <u>\$ 12,617.8</u> |

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

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WISCONSIN ENERGY CORPORATION  
CONSOLIDATED BALANCE SHEETS  
December 31

CAPITALIZATION AND LIABILITIES

|                               | <u>2009</u>           | <u>2008</u>    |
|-------------------------------|-----------------------|----------------|
|                               | (Millions of Dollars) |                |
| Capitalization                |                       |                |
| Common equity                 | \$ 3,566.9            | \$ 3,336.9     |
| Preferred stock of subsidiary | 30.4                  | 30.4           |
| Long-term debt                | 3,875.8               | 4,074.7        |
| Total Capitalization          | <u>7,473.1</u>        | <u>7,442.0</u> |
| <br>                          |                       |                |
| Current Liabilities           |                       |                |
| Long-term debt due currently  | 295.7                 | 61.8           |
| Short-term debt               | 825.1                 | 602.3          |
| Accounts payable              | 292.2                 | 441.0          |
| Regulatory liabilities        | 222.8                 | 310.8          |
| Other                         | 246.1                 | 319.2          |
| Total Current Liabilities     | <u>1,881.9</u>        | <u>1,735.1</u> |

|  |             |             |
|--|-------------|-------------|
| Deferred Credits and Other Liabilities       |             |             |
| Regulatory liabilities                       | 886.7       | 1,084.4     |
| Asset retirement obligations                 | 57.9        | 57.3        |
| Deferred income taxes - long-term            | 1,017.9     | 814.0       |
| Accumulated deferred investment tax credits  | 37.7        | 41.6        |
| Deferred revenue, net                        | 739.1       | 545.4       |
| Pension and other benefit obligations        | 319.5       | 635.0       |
| Other long-term liabilities                  | 284.1       | 263.0       |
| Total Deferred Credits and Other Liabilities | 3,342.9     | 3,440.7     |
| Commitments and Contingencies (Note S)       |             |             |
| Total Capitalization and Liabilities         | \$ 12,697.9 | \$ 12,617.8 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

WISCONSIN ENERGY CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Year Ended December 31

|   | <u>2009</u>           | <u>2008</u> | <u>2007</u> |
|---|-----------------------|-------------|-------------|
|   | (Millions of Dollars) |             |             |
| Operating Activities                                  |                       |             |             |
| Net income  | \$ 382.4              | \$ 359.1    | \$ 335.6    |
| Reconciliation to cash                                |                       |             |             |
| Depreciation, decommissioning and amortization        | 349.4                 | 332.1       | 337.7       |
| Amortization of gain                                  | (230.7)               | (488.1)     | (6.5)       |
| Equity in earnings of transmission affiliate          | (59.1)                | (51.8)      | (43.1)      |
| Distributions from transmission affiliate             | 46.6                  | 39.0        | 33.2        |
| Deferred income taxes and investment tax credits, net | 187.4                 | 296.6       | 20.4        |
| Deferred revenue                                      | 201.7                 | 203.2       | 164.5       |



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|  |                |                |                |
|--|----------------|----------------|----------------|
| Contributions to benefit plans                                 | (289.3)        | (48.4)         | (24.2)         |
| Change in - Accounts receivable and accrued revenues           | 111.1          | 7.5            | (36.9)         |
| Inventories  | (34.6)         | 16.6           | 31.3           |
| Other current assets   | 24.8           | (51.6)         | 9.1            |
| Accounts payable   | (118.5)        | 50.3           | 10.1           |
| Accrued income taxes, net                                      | 43.4           | (89.4)         | (106.9)        |
| Deferred costs, net  | 46.2           | 81.5           | (56.3)         |
| Other current liabilities                                      | (11.7)         | 8.0            | 0.3            |
| Other, net   | <u>(20.3)</u>  | <u>71.8</u>    | <u>(135.9)</u> |
| Cash Provided by Operating Activities                          | 628.8          | 736.4          | 532.4          |
| Investing Activities   |                |                |                |
| Capital expenditures   | (817.7)        | (1,136.4)      | (1,210.2)      |
| Investment in transmission affiliate                           | (25.9)         | (25.3)         | -              |
| Proceeds from asset sales, net                                 | 16.8           | 14.3           | 963.1          |
| Proceeds from liquidation of nuclear decommissioning trust     | -              | -              | 552.4          |
| Change in restricted cash                                      | 192.0          | 345.1          | (731.6)        |
| Proceeds from investments within nuclear decommissioning trust | -              | -              | 1,528.7        |
| Other activity within nuclear decommissioning trust            | -              | -              | (1,528.7)      |
| Other, net   | <u>(101.3)</u> | <u>(104.0)</u> | <u>(116.8)</u> |
| Cash Used in Investing Activities                              | (736.1)        | (906.3)        | (543.1)        |
| Financing Activities   |                |                |                |
| Exercise of stock options                                      | 17.0           | 11.6           | 36.1           |
| Purchase of common stock                                       | (29.6)         | (23.0)         | (67.8)         |
| Dividends paid on common stock                                 | (157.8)        | (126.3)        | (116.9)        |
| Issuance of long-term debt                                     | 261.5          | 1,113.0        | 523.4          |
| Retirement and repurchase of long-term debt                    | (221.1)        | (497.8)        | (363.8)        |
| Change in short-term debt                                      | 222.8          | (298.4)        | (11.2)         |
| Other, net   | <u>2.9</u>     | <u>(4.1)</u>   | <u>1.3</u>     |
| Cash Provided by Financing Activities                          | <u>95.7</u>    | <u>175.0</u>   | <u>1.1</u>     |
| Change in Cash and Cash Equivalents                            | (11.6)         | 5.1            | (9.6)          |
| Cash and Cash Equivalents at Beginning of Year                 | <u>32.5</u>    | <u>27.4</u>    | <u>37.0</u>    |
| Cash and Cash Equivalents at End of Year                       | <u>\$ 20.9</u> | <u>\$ 32.5</u> | <u>\$ 27.4</u> |

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

WISCONSIN ENERGY CORPORATION  
CONSOLIDATED STATEMENTS OF COMMON EQUITY

|   | Common<br>Stock       | Other Paid<br>In Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Stock<br>Options<br>Exercisable | Total      |
|---|-----------------------|--------------------------|----------------------|--|---------------------------------|------------|
|   | (Millions of Dollars) |                          |                      |  |                                 |            |
| Balance -<br>December 31,<br>2006                           | \$ 1.2                | \$ 755.5                 | \$ 2,133.3           | \$ (1.6)   | \$ 0.6                          | \$ 2,889.0 |
| Impact of<br>uncertainty in<br>income taxes.<br>See Note H. |                       |                          | (0.3)                |  |                                 | (0.3)      |
| Balance -<br>January 1, 2007                                | 1.2                   | 755.5                    | 2,133.0              | (1.6)  | 0.6                             | 2,888.7    |
| Net income  |                       |                          | 335.6                |  |                                 | 335.6      |
| Other<br>comprehensive<br>income                            |                       |                          |                      |  |                                 |            |
| Hedging, net  |                       |                          |                      | 0.3  |                                 | 0.3        |
| Comprehensive<br>income                                     | -                     | -                        | 335.6                | 0.3  | -                               | 335.9      |
| Common stock<br>cash  |                       |                          |                      |  |                                 |            |
| dividends of<br>\$1.00 per share                            |                       |                          | (116.9)              |  |                                 | (116.9)    |
| Exercise of<br>stock options                                |                       | 36.1                     |                      |  |                                 | 36.1       |
| Purchase of<br>common stock                                 |                       | (67.8)                   |                      |  |                                 | (67.8)     |
| Tax benefit from<br>share based                             |                       | 10.8                     |                      |  |                                 | 10.8       |

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|   |     |        |         |       |       |         |
|---|-----|--------|---------|-------|-------|---------|
| compensation                              |     |        |         |       |       |         |
| Stock-based compensation and other        |     | 12.9   | (0.3)   |       | (0.2) | 12.4    |
| Balance - December 31, 2007               | 1.2 | 747.5  | 2,351.4 | (1.3) | 0.4   | 3,099.2 |
| Net income                                |     |        | 359.1   |       |       | 359.1   |
| Other comprehensive income                |     |        |         |       |       |         |
| Hedging, net                              |     |        |         | 0.4   |       | 0.4     |
| Comprehensive income                      | -   | -      | 359.1   | 0.4   | -     | 359.5   |
| Common stock cash                         |     |        |         |       |       |         |
| dividends of \$1.08 per share             |     |        | (126.3) |       |       | (126.3) |
| Exercise of stock options                 |     | 11.6   |         |       |       | 11.6    |
| Purchase of common stock                  |     | (23.0) |         |       |       | (23.0)  |
| Tax benefit from share based compensation |     | 3.3    |         |       |       | 3.3     |
| Stock-based compensation and other        |     | 12.9   |         |       | (0.3) | 12.6    |
| Balance - December 31, 2008               | 1.2 | 752.3  | 2,584.2 | (0.9) | 0.1   | 3,336.9 |
| Net income                                |     |        | 382.4   |       |       | 382.4   |
| Other comprehensive income                |     |        |         |       |       |         |
| Hedging, net                              |     |        |         | 0.4   |       | 0.4     |
| Comprehensive income                      | -   | -      | 382.4   | 0.4   | -     | 382.8   |
| Common stock cash                         |     |        |         |       |       |         |
| dividends of \$1.35 per share             |     |        | (157.8) |       |       | (157.8) |
| Exercise of stock options                 |     | 17.0   |         |       |       | 17.0    |
|   |     | (29.6) |         |       |       | (29.6)  |

|   |        |          |            |          |      |            |
|---|--------|----------|------------|----------|------|------------|
| Purchase of common stock                  |        |          |            |          |      |            |
| Tax benefit from share based compensation |        | 6.3      |            |          |      | 6.3        |
| Stock-based compensation and other        |        | 11.4     |            | (0.1)    |      | 11.3       |
| Balance - December 31, 2009               | \$ 1.2 | \$ 757.4 | \$ 2,808.8 | \$ (0.5) | \$ - | \$ 3,566.9 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

WISCONSIN ENERGY CORPORATION  
CONSOLIDATED STATEMENTS OF CAPITALIZATION  
December 31

|   | 2009                  | 2008       |
|---|-----------------------|------------|
|   | (Millions of Dollars) |            |
| Common Equity (see accompanying statement)                      | \$ 3,566.9            | \$ 3,336.9 |
| Preferred Stock   |                       |            |
| Wisconsin Energy  |                       |            |
| \$.01 par value; authorized 15,000,000 shares; none outstanding | -                     | -          |
| Wisconsin Electric  |                       |            |
| Six Per Cent. Preferred Stock - \$100 par value;                |                       |            |
| authorized 45,000 shares; outstanding - 44,498 shares           | 4.4                   | 4.4        |
| Serial preferred stock -  |                       |            |
| \$100 par value; authorized 2,286,500 shares; 3.60% Series      | 26.0                  | 26.0       |

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redeemable at \$101 per share; outstanding -  
260,000 shares

\$25 par value; authorized 5,000,000 shares; none  
outstanding

|                              |   |         |       |
|------------------------------|---|---------|-------|
|                              |   | -       | -     |
| Total Preferred Stock        |   | 30.4    | 30.4  |
| Long-Term Debt               |   |         |       |
| Debentures (unsecured)       | 4.50% due 2013                                    | 300.0   | 300.0 |
|                              | 6.60% due 2013                                    | 45.0    | 45.0  |
|                              | 6.00% due 2014                                    | 300.0   | 300.0 |
|                              | 5.20% due 2015                                    | 125.0   | 125.0 |
|                              | 6.25% due 2015                                    | 250.0   | 250.0 |
|                              | 4.25% due 2019                                    | 250.0   | -     |
|                              | 6-1/2% due 2028                                   | 150.0   | 150.0 |
|                              | 5.625% due 2033                                   | 335.0   | 335.0 |
|                              | 5.90% due 2035                                    | 90.0    | 90.0  |
|                              | 5.70% due 2036                                    | 300.0   | 300.0 |
|                              | 6-7/8% due 2095                                   | 100.0   | 100.0 |
| Notes (secured, nonrecourse) | 2% stated rate due 2011                           | 0.1     | 0.1   |
|                              | 4.81% effective rate due<br>2030                  | 2.0     | 2.0   |
|                              | 4.91% due 2009-2030                               | 139.4   | 143.3 |
|                              | 6.00% due 2009-2033                               | 151.8   | 154.6 |
| Notes (unsecured)            | 5-1/2% due 2009                                   | -       | 50.0  |
|                              | 6.00% to 6.25% due<br>2010                        | 21.5    | 10.0  |
|                              | 2.73% variable rate due<br>2010 (a)               | 260.0   | 260.0 |
|                              | 6.50% due 2011                                    | 450.0   | 450.0 |
|                              | 6.51% due 2013                                    | 30.0    | 30.0  |
|                              | 1.92% variable rate due<br>2015 (b)               | -       | 17.4  |
|                              | 6.94% due 2028                                    | 50.0    | 50.0  |
|                              | 0.504% variable rate<br>due 2016 (a)              | 67.0    | 67.0  |
|                              | 0.504% variable rate<br>due 2030 (a)              | 80.0    | 80.0  |
|                              | Variable rate notes held<br>by Wisconsin Electric | (147.0) | -     |
|                              | 6.20% due 2033                                    | 200.0   | 200.0 |
| Junior Notes (unsecured)     | 6.25% due 2067                                    | 500.0   | 500.0 |

|                                     |                   |                   |
|-------------------------------------|-------------------|-------------------|
| Obligations under capital leases    | 149.0             | 154.1             |
| Unamortized discount, net and other | (27.3)            | (27.0)            |
| Long-term debt due currently        | (295.7)           | (61.8)            |
|                                     | <u>3,875.8</u>    | <u>4,074.7</u>    |
| Total Long-Term Debt                |                   |                   |
|                                     | <u>3,875.8</u>    | <u>4,074.7</u>    |
| Total Capitalization                | \$ 7,473.1        | \$ 7,442.0        |
|                                     | <u>\$ 7,473.1</u> | <u>\$ 7,442.0</u> |

(a) Variable interest rate as of December 31, 2009.

(b) Variable interest rate as of December 31, 2008.

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

## WISCONSIN ENERGY CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### A -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### General:

Our consolidated financial statements include the accounts of Wisconsin Energy Corporation (Wisconsin Energy, the Company, our, we or us), a diversified holding company, as well as our subsidiaries in the following operating segments:

- *Utility Energy Segment*

-- Consisting of Wisconsin Electric, Wisconsin Gas and Edison Sault; engaged primarily in the generation of electricity and the distribution of electricity and natural gas; and

- *Non-Utility Energy Segment*

-- Consisting primarily of We Power; engaged principally in the design, development, construction and ownership of electric power generating facilities for long-term lease to Wisconsin Electric.

Our Corporate and Other segment primarily includes Wispark, which develops and invests in real estate. We have also eliminated all intercompany transactions and balances within this segment from the consolidated financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the

reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events:

We have evaluated and determined that no material events took place after our balance sheet date of December 31, 2009 through our financial statement issuance date of February 26, 2010, except as disclosed in Note U.

Revenues:

We recognize energy revenues on the accrual basis and include estimated amounts for services rendered but not billed.

Our retail electric rates in Wisconsin are established by the PSCW and include base amounts for fuel and purchased power costs. The electric fuel rules in Wisconsin allow us to request rate increases if fuel and purchased power costs exceed the band established by the PSCW. We are also required to reduce rates if fuel and purchased power costs fall below the band established by the PSCW.

Our retail gas rates include monthly adjustments which permit the recovery or refund of actual purchased gas costs. We defer any difference between actual gas costs incurred (adjusted for a sharing mechanism) and costs recovered through rates as a current asset or liability. The deferred balance is returned to or recovered from customers at intervals throughout the year.

For information regarding revenue recognition for PTF, see Note E.

Accounting for MISO Energy Transactions:

The MISO Energy Markets operate under both day-ahead and real-time markets. We record energy transactions in the MISO Energy Markets on a net basis for each hour.

Other Income and Deductions, Net:

We recorded the following items in Other Income and Deductions, net for the years ended December 31:

| <u>Other Income and Deductions, net</u> | <u>2009</u>          | <u>2008</u>           | <u>2007</u>          |
|---|----------------------|-----------------------|----------------------|
|   |                      | (Millions of Dollars) |                      |
| Carrying Costs                          | \$ -                 | \$ 0.8                | \$28.8               |
| Gain on Property Sales                  | 1.7                  | 2.6                   | 13.1                 |
| AFUDC - Equity                          | 16.0                 | 7.8                   | 5.2                  |
| Other, net                              | <u>10.7</u>          | <u>5.8</u>            | <u>1.8</u>           |
| Total Other Income and Deductions, net  | <u><u>\$28.4</u></u> | <u><u>\$17.0</u></u>  | <u><u>\$48.9</u></u> |

Property and Depreciation:

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We record property, plant and equipment at cost. Cost includes material, labor, overheads and capitalized interest. Utility property also includes AFUDC - Equity. Additions to and significant replacements of property are charged to property, plant and equipment at cost; minor items are charged to maintenance expense. The cost of depreciable utility property less salvage value is charged to accumulated depreciation when property is retired.

We had the following property in service by segment as of December 31:

| <u>Property In Service</u> | <u>2009</u>       | <u>2008</u>      |
|----------------------------|-------------------|------------------|
| (Millions of Dollars)      |                   |                  |
| Utility Energy             | \$9,092.8         | \$8,878.0        |
| Non-Utility Energy         | 1,111.6           | 959.4            |
| Other                      | 82.2              | 72.0             |
| Total                      | <u>\$10,286.6</u> | <u>\$9,909.4</u> |

Our utility depreciation rates are certified by the PSCW and MPSC and include estimates for salvage value and removal costs. Depreciation as a percent of average depreciable utility plant was 3.7% in 2009, 2008 and 2007.

For assets other than our regulated assets, we accrue depreciation expense at straight-line rates over the estimated useful lives of the assets. Estimated useful lives for non-regulated assets are 3 to 40 years for furniture and equipment, 2 to 5 years for software and 30 to 40 years for buildings.

Our regulated utilities collect in their rates amounts representing future removal costs for many assets that do not have an associated ARO. We

record a regulatory liability on our balance sheet for the estimated amounts we have collected in rates for future removal costs less amounts we have spent in removal activities. This regulatory liability was \$729.4 million as of December 31, 2009 and \$693.5 million as of December 31, 2008.

We recorded the following CWIP by segment as of December 31:

| <u>CWIP</u>           | <u>2009</u>      | <u>2008</u>      |
|-----------------------|------------------|------------------|
| (Millions of Dollars) |                  |                  |
| Utility Energy        | \$386.7          | \$191.3          |
| Non-Utility Energy    | 1,794.8          | 1,638.6          |
| Other                 | 4.1              | -                |
| Total                 | <u>\$2,185.6</u> | <u>\$1,829.9</u> |

Allowance For Funds Used During Construction - Regulated:

AFUDC is included in utility plant accounts and represents the cost of borrowed funds (AFUDC - Debt) used during plant construction, and a return on stockholders' capital (AFUDC - Equity) used for construction purposes. AFUDC - Debt is recorded as a reduction of interest expense, and AFUDC - Equity is recorded in Other Income and Deductions, net.



During 2009 and 2008, Wisconsin Electric accrued AFUDC at a rate of 9.09% as authorized by the PSCW. Consistent with the PSCW's 2008 rate order, Wisconsin Electric accrued AFUDC on 50% of all utility CWIP

projects except the Oak Creek AQCS project which accrued AFUDC on 100% of CWIP. Wisconsin Electric's rates are set to provide a current return on CWIP that does not accrue AFUDC. During 2007, Wisconsin Electric accrued AFUDC at a rate of 8.94%, as authorized by the PSCW in a prior rate order. Based on the 2010 PSCW rate order, effective January 1, 2010 Wisconsin Electric is recording AFUDC on 100% of CWIP associated with the Oak Creek AQCS project, the Edgewater Unit 5 Selective Catalytic Reduction project, and the Glacier Hills Wind Park. Wisconsin Electric will record AFUDC on 50% of all other electric, gas, and steam utility CWIP. The AFUDC rate starting January 1, 2010 is 8.83%.

During 2009 and 2008, Wisconsin Gas accrued AFUDC at a rate of 10.80% on 50% of its CWIP as authorized by the PSCW in the 2008 rate order. Wisconsin Gas' rates are set to provide a current return on CWIP that does not accrue AFUDC. During 2007, Wisconsin Gas accrued AFUDC at a rate of 11.31%, as authorized by the PSCW in a prior rate order. Based on the 2010 PSCW rate order, effective January 1, 2010 Wisconsin Gas is recording AFUDC on 50% of all CWIP using an AFUDC rate of 9.05%.

Our regulated segment recorded the following AFUDC for the years ended December 31:

|                | <u>2009</u>           | <u>2008</u> | <u>2007</u> |
|----------------|-----------------------|-------------|-------------|
|                | (Millions of Dollars) |             |             |
| AFUDC - Debt   | \$6.7                 | \$3.3       | \$1.8       |
| AFUDC - Equity | \$16.0                | \$7.8       | \$5.2       |

#### Capitalized Interest and Carrying Costs - Non-Regulated Energy:

As part of the construction of the power plants under our PTF program, we capitalize interest during construction. Under the lease agreements associated with our PTF power plants, we are able to collect from utility customers the carrying costs associated with the construction of these power plants. We defer these carrying costs collected on our balance sheet and they will be amortized to revenue once the asset is placed in service over the individual lease term. For further information on the accounting for capitalized interest and deferred carrying costs associated with the construction of our PTF power plants, see Note E.

#### Earnings per Common Share:

We compute basic earnings per common share by dividing our net income by the weighted average number of common shares outstanding. Diluted earnings per common share reflect the potential reduction in earnings per common share that could occur when potentially dilutive common shares are added to common shares outstanding.

We derive our potentially dilutive common shares by calculating the number of shares issuable relating to stock options utilizing the treasury stock method. The future issuance of shares underlying the outstanding stock options depends on whether the exercise prices of the stock options are less than the average market price of the common shares for the respective periods. Shares that are anti-dilutive are not included in the calculation.

## Materials, Supplies and Inventories:

Our inventory at December 31 consists of:

| Materials, Supplies and<br>Inventories | 2009                  | 2008           |
|--|-----------------------|----------------|
|  | (Millions of Dollars) |                |
| Fossil Fuel                            | \$181.1               | \$132.4        |
| Natural Gas in Storage                 | 93.3                  | 113.3          |
| Materials and Supplies                 | 104.9                 | 99.0           |
| Total                                  | <u>\$379.3</u>        | <u>\$344.7</u> |

Substantially all fossil fuel, materials and supplies and natural gas in storage inventories are recorded using the weighted-average cost method of accounting.

## Regulatory Accounting:

The economic effects of regulation can result in regulated companies recording costs that have been or are expected to be allowed in the rate making process in a period different from the period in which the costs would be charged to expense by an unregulated enterprise. When this occurs, costs are deferred as assets on the balance sheet (regulatory assets) and recorded as expenses in the periods when those same amounts are reflected

in rates. We defer regulatory assets pursuant to specific orders or by a generic order issued by our regulators. Additionally, regulators can impose liabilities upon a regulated company for amounts previously collected from customers and for amounts that are expected to be refunded to customers (regulatory liabilities). We expect to recover our outstanding regulatory assets in rates over a period of no longer than 20 years. Regulatory assets and liabilities that are expected to be amortized within one year are recorded as current on the balance sheet. For further information, see Note C.

## Asset Retirement Obligations:

We record a liability for a legal ARO in the period in which it is incurred. When a new legal obligation is recorded, we capitalize the costs of the liability by increasing the carrying amount of the related long-lived asset. We accrete the liability to its present value each period and depreciate the capitalized cost over the useful life of the related asset. At the end of the asset's useful life, we settle the obligation for its recorded amount or incur a gain or loss. As it relates to our regulated operations, we apply regulatory accounting guidance and recognize regulatory assets or liabilities for the timing differences between when we recover legal AROs in rates and when we would recognize these costs. For further information, see Note F.

## Derivative Financial Instruments:

We have derivative physical and financial instruments which we report at fair value. For further information, see Note M.

## Cash and Cash Equivalents:

Cash and cash equivalents include marketable debt securities acquired three months or less from maturity.

#### Restricted Cash:

Cash proceeds that we received from the sale of Point Beach that are to be used for the benefit of our customers are recorded as restricted cash. As of December 31, 2009, all restricted cash is classified as current.

#### Margin Accounts:

Cash deposited in brokerage accounts for margin requirements is recorded in Other Current Assets on our Consolidated Balance Sheets.

#### Goodwill and Intangible Assets:

We account for goodwill and other intangible assets following accounting guidance for intangibles and goodwill. As of December 31, 2009 and 2008, we had \$441.9 million of goodwill recorded at the utility energy segment, which related to our acquisition of Wisconsin Gas in 2000.

Goodwill and other intangibles with indefinite lives are not subject to amortization. However, goodwill and other intangibles are subject to fair value-based rules for measuring impairment, and resulting write-downs, if any, are to be reflected in operating expense. We assess the fair value of our reporting unit by considering future discounted cash flows, a comparison of fair value based on public company trading multiples, and merger and acquisition transaction multiples for similar companies. This evaluation utilizes the information available under the circumstances, including reasonable and supportable assumptions and projections. We perform our annual impairment test for the reporting unit as of August 31. There was no impairment to the recorded goodwill balance as of our annual 2009 impairment test date for our reporting unit.

#### Impairment or Disposal of Long Lived Assets:

We carry property, equipment and goodwill related to businesses held for sale at the lower of cost or estimated fair value less cost to sell. As of December 31, 2009, we had no assets classified as Held for Sale. Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying value may not be recoverable from the use and eventual disposition of the asset based on the remaining useful life. An impairment loss is recognized when the carrying amount of an asset is not recoverable and exceeds the fair value of the asset. The carrying amount of an asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. An impairment loss is measured as the excess of the carrying amount of the asset in comparison to the fair value of the asset. For further information, see Note D.

#### Investments:

We account for investments in other affiliated companies in which we do not maintain control using the equity method. As of December 31, 2009 and 2008, we had a total ownership interest of approximately 26.2% in ATC. We are represented by one out of ten ATC board members, each of whom has one vote. Due to the voting requirements, no individual member has more than 10% of the voting control. For further information regarding such investments, see Note R.

#### Income Taxes:

We follow the liability method in accounting for income taxes. Accounting guidance for income taxes requires the recording of deferred assets and liabilities to recognize the expected future tax consequences of events that have been reflected in our financial statements or tax returns and the adjustment of deferred tax balances

to reflect tax rate changes. We are required to assess the likelihood that our deferred tax assets would expire before being realized. We have established a valuation allowance against certain deferred tax assets. GAAP requires that, if we conclude in a future period that it is more likely than not that some or all of the deferred tax assets would be realized before expiration, we reverse the related valuation allowance in that period. Any change to the allowance, as a

result of a change in judgment about the realization of deferred tax assets, is reported in income tax expense.

Investment tax credits associated with regulated operations are deferred and amortized over the life of the assets. We file a consolidated Federal income tax return. Accordingly, we allocate Federal current tax expense benefits and credits to our subsidiaries based on their separate tax computations. For further information, see Note H.

We recognize interest and penalties accrued related to unrecognized tax benefits in Income Taxes in our Consolidated Income Statements, as well as Regulatory Assets or Regulatory Liabilities in our Consolidated Balance Sheets.

We collect sales and use taxes from our customers and remit these taxes to governmental authorities. These taxes are recorded in our Consolidated Income Statements on a net basis.

#### Stock Options:

We estimate the fair value of stock options using the binomial pricing model. We report unearned stock-based compensation associated with non-vested restricted stock and performance share awards activity within "other paid in capital" in our Consolidated Statements of Common Equity. We report excess tax benefits as a financing cash inflow. Historically, all stock options have been granted with an exercise price equal to the fair market value of the common stock on the date of grant and expire no later than 10 years from the grant date. For a discussion of the impacts to our Consolidated Financial Statements, see Note J.

The fair value of our stock options was calculated using a binomial option-pricing model using the following weighted average assumptions:

|  | <u>2009</u> | <u>2008</u> | <u>2007</u>   |
|--|-------------|-------------|---------------|
| Risk free interest rate  | 0.3% - 2.5% | 2.9% - 3.9% | 4.7% - 5.1%   |
| Dividend yield   | 3.0%        | 2.1%        | 2.2%          |
| Expected volatility  | 25.9%       | 20.0%       | 13.0% - 20.0% |
| Expected life (years)  | 6.2         | 6.2         | 6.0           |
| Expected forfeiture rate   | 2.0%        | 2.0%        | 2.0%          |
| Pro forma weighted average fair value of our stock options granted | \$8.01      | \$9.39      | \$8.72        |

## B -- RECENT ACCOUNTING PRONOUNCEMENTS

#### Fair Value Measurements:

In September 2006, the FASB issued new accounting guidance relating to fair value measurements and also issued updated accounting guidance in 2008 and 2009. This guidance defines fair value, provides guidance for using fair value to measure assets and liabilities as well as a framework for measuring fair value, expands disclosures related to fair value measurements and was effective for financial statements issued for fiscal years beginning after November 15, 2007. This adoption did not have a significant financial impact on our financial condition, results of operations or cash flow. See Note N -- Fair Value Measurements for required disclosures.

#### Noncontrolling Interests in Consolidated Financial Statements:

In December 2008, the FASB issued new accounting guidance relating to noncontrolling interests in consolidated financial statements. This guidance clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements and was effective for fiscal years beginning on or after December 15, 2008. We adopted these provisions effective January 1, 2009. This adoption did not have a material financial impact on our financial condition, results of operations or

cash flows.

#### Disclosures about Derivative Instruments and Hedging Activities:

In March 2008, the FASB issued new accounting guidance relating to derivative instruments and hedging activities. This guidance requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements, and was effective for fiscal years beginning after November 15, 2008. We adopted these provisions

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effective January 1, 2009. This adoption did not have any financial impact on our financial condition, results of operations or cash flows. See Note M -- Derivative Instruments for required disclosures.

#### Subsequent Events:

In May 2009, the FASB issued new accounting guidance relating to management's assessment of subsequent events. This guidance clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date the financial statements are issued or are available to be issued, and was effective for interim and annual periods ending after June 15, 2009. We adopted these provisions effective June 30, 2009. This adoption had no financial impact on our financial condition, results of operations or cash flows.

#### Recognition and Presentation of Other-Than-Temporary Impairments:

In April 2009, the FASB issued new accounting guidance that amended the other-than-temporary impairment guidance for debt securities to be more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in financial statements. We adopted these provisions effective June 30, 2009. This adoption had no financial impact on our financial condition, results of operations or cash flows.

#### Amendments to Variable Interest Entity Consolidation Guidance:

In June 2009, the FASB issued new accounting guidance related to variable interest entity consolidation. The purpose of this guidance is to improve financial reporting by enterprises with variable interest entities. The new guidance is effective for all new and existing variable interest entities for fiscal years beginning after November 15, 2009. We adopted these provisions on January 1, 2010. This adoption is not expected to have any impact on our financial condition, results of operations or cash flows.

#### Employers' Disclosures about Post-retirement Benefit Plan Assets

: In December 2008, the FASB issued new accounting guidance for employer's disclosures about plan assets of defined benefit pension or other post-retirement plans. This new guidance resulted in expanded disclosures related to post-retirement benefit plan assets and was effective for fiscal years ending after December 15, 2009. We adopted these provisions on December 31, 2009. This adoption had no impact on our financial condition, results of operations or cash flows. See Note O -- Benefits for required disclosures.

#### C -- REGULATORY ASSETS AND LIABILITIES

Our primary regulator, the PSCW, considers our regulatory assets and liabilities in two categories, escrowed and deferred. In escrow accounting we expense amounts that are included in rates. If actual costs exceed, or are less than

the amounts that are allowed in rates, the difference in cost is escrowed on the balance sheet as a regulatory asset or regulatory liability and the escrowed balance is considered in setting future rates. Under deferred cost accounting, we defer amounts to our balance sheet based upon orders or correspondence with our regulators. These deferred costs will be considered in future rate setting proceedings. As of December 31, 2009 and 2008, we had approximately \$17.4 million and \$28.2 million, respectively, of net regulatory assets that were not earning a return.

In December 2009, the PSCW issued a rate order effective January 1, 2010 that, among other things, reaffirmed our accounting for the regulatory assets and liabilities identified below. The rate order provided for the recovery over an eight year period of specific regulatory assets, the largest of which is the balance of the remaining deferred transmission costs. The order also specified that the deferred Point Beach gain would be passed on to customers as authorized in the prior rate case such that the final credits should essentially be issued by the end of 2010.

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Our regulatory assets and liabilities as of December 31 consist of:

|   | 2009                  | 2008             |
|---|-----------------------|------------------|
|   | (Millions of Dollars) |                  |
| Regulatory Assets                       |                       |                  |
| Deferred unrecognized pension costs     | \$561.9               | \$593.6          |
| Escrowed electric transmission costs    | 157.8                 | 199.0            |
| Deferred unrecognized OPEB costs        | 122.1                 | 107.7            |
| Deferred income tax related             | 78.8                  | 73.4             |
| Deferred plant related -- capital lease | 78.5                  | 77.9             |
| Deferred environmental costs            | 68.1                  | 56.8             |
| Deferred derivative amounts             | 19.1                  | 84.4             |
| Other, net                              | 165.1                 | 150.8            |
| Total regulatory assets                 | <u>\$1,251.4</u>      | <u>\$1,343.6</u> |
| Regulatory Liabilities                  |                       |                  |
| Deferred cost of removal obligations    | \$729.4               | \$693.5          |
| Deferred Point Beach related            | 202.4                 | 431.5            |
| Deferred income tax related             | 52.3                  | 89.2             |
| Other, net                              | 125.4                 | 181.0            |
| Total regulatory liabilities            | <u>\$1,109.5</u>      | <u>\$1,395.2</u> |

We have concluded that substantially all of the unrecognized costs resulting from the recognition of the funded status of our pension and OPEB plans qualify as a regulatory asset.

Our regulated subsidiaries record deferred regulatory assets and liabilities representing the future expected impact of deferred taxes on utility revenues, see Note A.

Consistent with a generic order from, and past rate-making practices of the PSCW, we defer as a regulatory asset, costs associated with the remediation of former manufactured gas plant sites. As of December 31, 2009, we have recorded \$68.1 million of environmental costs associated with manufactured gas plant sites as a regulatory asset, including \$15.9 million of deferrals for actual remediation costs incurred and a \$52.2 million accrual for estimated future site remediation (see Note S). In addition, we have deferred \$5.3 million of insurance recoveries associated with the environmental costs as regulatory liabilities. We amortize the deferred costs actually incurred and insurance recoveries over five years in accordance with rate-making treatment.

As of December 31, 2009, we have \$28.7 million of escrowed bad debt costs. The PSCW authorized escrow accounting for residential bad debt costs for both Wisconsin Gas and Wisconsin Electric whereby they defer actual bad debt write-offs that exceed amounts allowed in rates.

## D -- ASSET SALES, DIVESTITURES AND DISCONTINUED OPERATIONS

### Edgewater Generating Unit 5:

During the fourth quarter of 2009, we reached a contingent agreement to sell our 25% interest in Edgewater Generating Unit 5 to WPL, which will become binding if we are unable to reach an agreement with a third party to sell our interest. We are continuing to negotiate with a third party to sell our interest in this unit. The completion of any sale will be subject to approval by the PSCW.

### Edison Sault:

In October 2009, we announced that we had reached an agreement to sell Edison Sault to Cloverland Electric Cooperative for approximately \$61.5 million for a nominal gain. We will retain the membership interest in ATC currently held by Edison Sault. The sale is contingent upon certain conditions, including the approval by regulatory bodies. If the conditions are satisfied, we expect the sale to be completed in 2010. For the year ended December 31, 2009, Edison Sault's operating revenues were \$65.3 million.

### Water Utility Operations:

Effective April 30, 2009, we sold our water utility to the City of Mequon, Wisconsin for approximately \$14.5 million. The assets and liabilities associated with our water utility, reclassified as held for sale within other current assets and liabilities on our Consolidated Balance Sheet as of December 31, 2008, were \$14.4 million and \$0.3 million, respectively. We also reclassified the water utility income as discontinued operations in the accompanying Consolidated Income Statements.

The following table summarizes the net impacts of the discontinued operations of the water utility on our earnings for the years ended December 31:

|                                   | <u>2009</u>           | <u>2008</u> | <u>2007</u> |
|-----------------------------------|-----------------------|-------------|-------------|
|                                   | (Millions of Dollars) |             |             |
| Income from Continuing Operations | \$377.2               | \$357.8     | \$335.7     |

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|  |                |                |                |
|--|----------------|----------------|----------------|
| Income from Discontinued water operations, net of tax            | 0.3            | 0.8            | 0.8            |
| Income (Loss) from Discontinued other operations, net of tax (a) | 4.9            | 0.5            | (0.9)          |
| Net Income   | <u>\$382.4</u> | <u>\$359.1</u> | <u>\$335.6</u> |

- (a) During 2009, we reduced the amount of unrecognized tax benefits by approximately \$5.6 million due to the favorable resolution of an uncertain tax position.

Discontinued water operations had no material impact on the Consolidated Statement of Cash Flows for the years ended December 31, 2009, 2008 and 2007.

Point Beach:

Prior to September 28, 2007, Wisconsin Electric owned two 518 MW electric generating units (Unit 1 and Unit 2) at Point Beach in Two Rivers, Wisconsin. On September 28, 2007, Wisconsin Electric sold Point Beach to an affiliate of FPL for approximately \$924 million. Pursuant to the terms of the sale agreement, the buyer purchased Point Beach, its nuclear fuel and associated inventories and assumed the obligation to decommission the plant. Wisconsin Electric retained approximately \$506 million of the sales proceeds, which represents the net book value of the assets sold and certain transaction costs. In addition, Wisconsin Electric deferred the net gain on the sale of approximately \$418 million as a regulatory liability and deposited those proceeds into a restricted cash account. In connection with the sale, Wisconsin Electric also transferred \$390 million of decommissioning funds to the buyer. Wisconsin Electric then liquidated the balance of the decommissioning trust assets and retained approximately \$552 million of that cash. This cash was also placed into the restricted cash account. We are using the cash in the restricted cash account, and the interest earned on the balance, for the benefit of our customers and to pay certain taxes.

As of December 31, 2009, we have given approximately \$577.8 million in bill credits to our Wisconsin and Michigan retail customers and issued a refund of approximately \$62.5 million to wholesale customers in a one-time FERC-approved settlement. In addition, pursuant to the January 2008 PSCW rate order, during the first quarter of 2008, we used \$85.0 million of restricted cash proceeds to recover \$85.0 million of regulatory assets.

A long-term power purchase agreement with the buyer became effective upon closing of the sale. Pursuant to this agreement, Wisconsin Electric is purchasing all of the energy produced by Point Beach. The power purchase agreement extends through 2030 for Unit 1 and 2033 for Unit 2. Based on the agreement, we will be paying a predetermined price per MWh for energy delivered. Under the agreement, if our credit rating and the credit rating of Wisconsin Electric from either S&P or Moody's fall below investment grade, or if the holders of any indebtedness in excess of \$100.0 million accelerate or have the right to accelerate the maturity of such indebtedness as a result of a default, we would need to provide collateral in the amount of \$100.0 million (escalating at 3% per year commencing in 2024). For further information regarding our former nuclear operations, see Note I.

E -- ACCOUNTING AND REPORTING FOR POWER THE FUTURE GENERATING UNITS

Background:

As part of our PTF strategy, our non-utility subsidiary, We Power, has built three new generating units (PWGS 1, PWGS 2 and OC 1) and is in the process of building another new generating unit, OC 2, which are being/will be leased to our utility subsidiary, Wisconsin Electric, under long-term leases that have been approved by the PSCW. The leases are designed to recover the capital costs of the plant including a return. PWGS 1 was placed in service in July 2005, PWGS 2 was placed in service in May 2008 and OC 1 was placed in service on February 2, 2010. The accompanying consolidated financial statements eliminate all intercompany transactions between We Power and Wisconsin Electric and reflect the cash inflows from Wisconsin Electric customers and the cash outflows to our



vendors and suppliers.

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The Oak Creek expansion includes common projects that will benefit the existing units at this site as well as the new units. These projects include a coal handling facility and a water intake system, which were placed into service in November 2007 and January 2009, respectively.

#### During Construction:

Under the terms of each lease, we collect in current rates amounts representing our pre-tax cost of capital (debt and equity) associated with capital expenditures for our PTF units. Our pre-tax cost of capital is approximately 14%. The carrying costs that we collect in rates are recorded as deferred revenue and will be amortized to revenue over the term of each lease once the respective unit is placed into service. During the construction of our PTF units, we capitalize interest costs at an overall weighted-average pre-tax cost of interest which was approximately 5% for the year ended December 31, 2009 and approximately 6% in 2008. Capitalized interest is included in the total cost of the PTF units shown below.

#### Cash Flows:

The following table identifies key pre-tax cash outflows and inflows related to the construction of our PTF units for the years ended December 31:

|                      | <u>2009</u>           | <u>2008</u> | <u>2007</u> |
|----------------------|-----------------------|-------------|-------------|
|                      | (Millions of Dollars) |             |             |
| Capital Expenditures | \$248.2               | \$526.4     | \$665.6     |
| Capitalized Interest | \$71.8                | \$83.3      | \$71.4      |
| Deferred Revenue     | \$201.7               | \$203.2     | \$164.5     |

#### Balance Sheet:

As noted above, we collect in current rates carrying costs that are calculated based on the cash expenditures included in CWIP multiplied by our pre-tax cost of capital. The carrying costs are recorded as deferred revenue and included in long-term liabilities. Our total CWIP balance includes cash expenditures, capitalized interest and accruals. The following table identifies key amounts related to our PTF units that are recorded on our balance sheet as of December 31:

|                          | <u>2009</u>           | <u>2008</u> |
|--------------------------|-----------------------|-------------|
|                          | (Millions of Dollars) |             |
| CWIP - Cash Expenditures | \$1,575.8             | \$1,473.7   |
| Total CWIP               | \$1,792.2             | \$1,636.8   |
| Net Plant in Service     | \$1,010.7             | \$887.0     |
| Deferred Revenue         | \$739.1               | \$545.4     |

#### Income Statement:

Once the PTF units are placed in service, we expect to recover in rates the lease costs which reflect the authorized cash construction costs of the units plus a return on the investment. The authorized cash costs are established by the PSCW. The authorized cash costs exclude capitalized interest since carrying costs are recovered during the construction of the units. The lease payments are expected to be levelized, except that OC 1

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and OC 2 will be recovered on a levelized basis that has a one time 10.6% escalation after the first five years of the leases. The leases established a set return on equity component of 12.7% after tax. The interest component of the return is determined up to 180 days prior to the date that the units are placed in service.

We recognize revenues related to the lease payments that are included in our rates. In addition, our revenues include the amortization of the deferred revenues that reflect the carrying costs that are collected during construction. The deferred revenue is amortized over the lease term. Once the plants are placed in service, the combination of the lease payments and the amortization of the deferred revenue will result in a levelized annual revenue stream over the lease term. We depreciate the units on a straight line basis over their expected service life.

PWGS 1 and PWGS 2 were placed in service in July 2005 and May 2008, respectively. PWGS 1 had a cost of approximately \$364.3 million, including approximately \$31.1 million of capitalized interest and PWGS 2 had a cost of \$366.0 million, including approximately \$34.0 million of capitalized interest. Each asset is being depreciated over their estimated useful life of 37 years. The cost of the plant, plus a return on the investment, is expected to be recovered through Wisconsin Electric's rates over a 25 year period. Annual revenues for PWGS 1 and PWGS 2 are approximately \$50.9 million and \$52.2 million, respectively.

In November 2007, the coal handling system for Oak Creek was placed in service. This asset had a cost of approximately \$199.1 million (including capitalized interest) and is being depreciated over its estimated useful life of 40 years. The cost of the system, plus a return on the investment, is expected to be recovered through Wisconsin

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Electric's rates over a 32 year period at an annual amount of approximately \$24 million. In January 2009, the new water intake system that serves both the existing units at Oak Creek and OC 1 and OC 2 was placed in service. This asset had a cost of approximately \$132.6 million (including capitalized interest) and is being depreciated over its estimated useful life of 40 years. The cost of the system, plus a return on investment, is expected to be recovered through Wisconsin Electric's rates over a 31 year period at an annual amount of approximately \$16 million.

### F -- ASSET RETIREMENT OBLIGATIONS

The following table presents the change in our AROs during 2009:

|      | Balance at<br><u>12/31/08</u> | Liabilities<br><u>Incurred</u> | Liabilities<br><u>Settled</u> | Accretion | Cash Flow<br><u>Revisions</u> | Balance at<br><u>12/31/09</u> |
|------|-------------------------------|--------------------------------|-------------------------------|-----------|-------------------------------|-------------------------------|
|      | (Millions of Dollars)         |                                |                               |           |                               |                               |
| AROs | \$57.3                        | \$ -                           | (\$2.6)                       | \$3.2     | \$ -                          | \$57.9                        |

### G -- VARIABLE INTEREST ENTITIES

The primary beneficiary of a variable interest entity must consolidate the related assets and liabilities. Certain disclosures are required by sponsors, significant interest holders in variable interest entities and potential variable interest entities.

We assess our relationships with potential variable interest entities such as our coal suppliers, natural gas suppliers, coal and gas transporters, and other counterparties in power purchase agreements and joint

ventures. In making this assessment, we consider the potential that our contracts or other arrangements provide subordinated financial support, the potential for us to absorb losses or rights to residual returns of the entity, the ability to directly or indirectly make decisions about the entities' activities and other factors.

We have identified two tolling and purchased power agreements with third parties but have been unable to determine if we are the primary beneficiary of these two variable interest entities. The requested information required to make this determination has not been supplied. As a result, we do not consolidate these entities. We account for one of these contracts as a capital lease and the other contract as an operating lease. We have approximately \$417.9 million of required payments over the remaining terms of these two agreements, which expire over the next 13 years. We believe the required payments or any replacement power purchased will continue to be recoverable in rates. Total capacity and lease payments under these contracts for the periods ended December 31, 2009, 2008 and 2007 were \$62.2 million, \$66.4 million and \$70.4 million respectively.

## H -- INCOME TAXES

The following table is a summary of income tax expense for each of the years ended December 31:

| <u>Income Taxes</u>           | <u>2009</u>           | <u>2008</u>    | <u>2007</u>    |
|-------------------------------|-----------------------|----------------|----------------|
|                               | (Millions of Dollars) |                |                |
| Current tax expense (benefit) | \$29.9                | (\$80.2)       | \$300.0        |
| Deferred income taxes, net    | 191.2                 | 303.0          | (79.9)         |
| Investment tax credit, net    | <u>(3.8)</u>          | <u>(6.3)</u>   | <u>(4.2)</u>   |
| Total Income Tax Expense      | <u>\$217.3</u>        | <u>\$216.5</u> | <u>\$215.9</u> |

The provision for income taxes for each of the years ended December 31 differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to income before income taxes as a result of the following:

|                           | <u>2009</u>   |                           | <u>2008</u>   |                           | <u>2007</u>   |                           |
|---------------------------|---------------|---------------------------|---------------|---------------------------|---------------|---------------------------|
|                           | <u>Amount</u> | <u>Effective Tax Rate</u> | <u>Amount</u> | <u>Effective Tax Rate</u> | <u>Amount</u> | <u>Effective Tax Rate</u> |
| <u>Income Tax Expense</u> |               |                           |               |                           |               |                           |

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(Millions of Dollars)

|   |                |               |                |              |                |              |
|---|----------------|---------------|----------------|--------------|----------------|--------------|
| Expected tax at                               |                |               |                |              |                |              |
| statutory federal tax rates                   | \$208.1        | 35.0%         | \$201.0        | 35.0%        | \$193.0        | 35.0%        |
| State income taxes net of federal tax benefit | 32.5           | 5.5%          | 30.1           | 5.2%         | 26.9           | 4.9%         |
| Production tax credits - wind                 | (7.1)          | (1.2%)        | (4.8)          | (0.8%)       | (0.1)          | -%           |
| Domestic production activities deduction      | (8.3)          | (1.4%)        | (8.0)          | (1.4%)       | -              | -%           |
| Investment tax credit restored                | (3.8)          | (0.6%)        | (6.3)          | (1.1%)       | (4.2)          | (0.8%)       |
| Other, net                                    | (4.1)          | (0.7%)        | 4.5            | 0.8%         | 0.3            | -%           |
| Total Income Tax Expense                      | <u>\$217.3</u> | <u>36.6 %</u> | <u>\$216.5</u> | <u>37.7%</u> | <u>\$215.9</u> | <u>39.1%</u> |

The components of deferred income taxes classified as net current assets and net long-term liabilities as of December 31 are as follows:

|                                       | <u>2009</u>           | <u>2008</u>           |
|---------------------------------------|-----------------------|-----------------------|
|                                       | (Millions of Dollars) |                       |
| <u>Deferred Tax Assets</u>            |                       |                       |
| Current                               |                       |                       |
| Deferred Gain                         | \$21.3                | \$37.0                |
| Employee benefits and compensation    | 14.2                  | 14.9                  |
| Other                                 | 12.4                  | 12.8                  |
| Total Current Deferred Tax Assets     | <u>\$47.9</u>         | <u>\$64.7</u>         |
| Non-current                           |                       |                       |
| Deferred revenues                     | 270.8                 | \$204.6               |
| Construction advances                 | 115.5                 | 109.6                 |
| Employee benefits and compensation    | 105.8                 | 95.1                  |
| Property-related                      | 32.5                  | 52.9                  |
| Deferred gain                         | -                     | 27.2                  |
| Emission allowances                   | 4.0                   | 13.0                  |
| State NOL's                           | 1.7                   | 3.9                   |
| Other                                 | 11.7                  | 20.5                  |
| Total Non-current Deferred Tax Assets | <u>\$542.0</u>        | <u>\$526.8</u>        |
| Total Deferred Tax Assets             | <u><u>\$589.9</u></u> | <u><u>\$591.5</u></u> |

|   | 2009                  | 2008             |
|---|-----------------------|------------------|
|   | (Millions of Dollars) |                  |
| <b>Deferred Tax Liabilities</b>                   |                       |                  |
| <b>Current</b>                                    |                       |                  |
| Prepaid items                                     | \$47.3                | \$45.2           |
| <b>Total Current Deferred Tax Liabilities</b>     | <b>\$47.3</b>         | <b>\$45.2</b>    |
| <b>Non-current</b>                                |                       |                  |
| Property-related                                  | \$1,174.9             | \$986.1          |
| Employee benefits and compensation                | 171.8                 | 169.9            |
| Deferred transmission costs                       | 63.2                  | 76.4             |
| Investment in transmission affiliate              | 91.7                  | 59.5             |
| Other   | 58.3                  | 48.9             |
| <b>Total Non-current Deferred Tax Liabilities</b> | <b>\$1,559.9</b>      | <b>\$1,340.8</b> |
| <b>Total Deferred Tax Liabilities</b>             | <b>\$1,607.2</b>      | <b>\$1,386.0</b> |
| <b>Consolidated Balance Sheet Presentation</b>    |                       |                  |
| Current Deferred Tax Asset                        | \$0.6                 | \$19.5           |
| Non-current Deferred Tax Liability                | \$1,017.9             | \$814.0          |

Consistent with ratemaking treatment, deferred taxes are offset in the above table for temporary differences which have related regulatory assets or liabilities.

As of December 31, 2009 and 2008, we had recorded \$3.1 million and \$3.2 million, respectively, of valuation allowances primarily related to the uncertainty of our ability to benefit from state loss carryforwards in the future. Portions of these state loss carryforwards began expiring in 2008.

On January 1, 2007, we adopted accounting guidance related to uncertainty in income taxes. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|  | 2009                  | 2008 |
|--|-----------------------|------|
|  | (Millions of Dollars) |      |

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|  |               |               |
|--|---------------|---------------|
| Balance, January 1   | \$37.0        | \$33.2        |
| Additions based on tax positions related to the current year | 1.4           | -             |
| Additions for tax positions of prior years                   | 4.8           | 5.6           |
| Reductions for tax positions of prior years                  | (7.1)         | (0.6)         |
| Reductions due to statute of limitations                     | (0.2)         | (1.2)         |
| Settlements during the period                                | (0.5)         | -             |
| Balance, December 31   | <u>\$35.4</u> | <u>\$37.0</u> |

The amount of unrecognized tax benefits as of December 31, 2009 and 2008 excludes deferred tax assets related to uncertainty in income taxes of \$15.8 million and \$13.2 million, respectively. As of December 31, 2009 and 2008, the net amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate for continuing operations was approximately \$9.1 million and \$9.3 million, respectively.

We recognize interest and penalties accrued related to unrecognized tax benefits as a component of income tax expense. For the years ended December 31, 2009, 2008 and 2007, we recognized approximately \$2.0 million, \$3.3 million and \$3.0 million, respectively, of accrued interest in the Consolidated Income Statements. For the years ended December 31, 2009, 2008 and 2007, we recognized no penalties in the Consolidated Income Statements. As of December 31, 2009 and 2008, we had approximately \$9.1 million and \$9.0 million of interest accrued and approximately \$0.3 million and \$0.9 million of penalties accrued on the Consolidated Balance Sheets as of December 31, 2009 and 2008, respectively.

We do not anticipate any significant increases or decreases in the total amounts of unrecognized tax benefits within the next 12 months.

Our primary tax jurisdictions include Federal and the state of Wisconsin. Currently, the tax years of 2004 through 2009 are subject to Federal and Wisconsin examination.

#### I -- NUCLEAR OPERATIONS

The sale of Point Beach was completed on September 28, 2007.

##### Nuclear Decommissioning:

We recorded decommissioning expense in amounts equal to the amounts collected in rates and funded to the external trusts. Nuclear decommissioning costs were accrued over the expected service lives of the nuclear generating units and were included in electric rates. The decommissioning funding was \$11.2 million through September 2007. We liquidated our decommissioning trust assets as part of the sale of Point Beach.

#### J -- Common equity

As of December 31, 2009 and 2008, we had 325,000,000 shares of common stock authorized under our charter, of which 116,908,346 and 116,917,790 common shares, respectively, were outstanding. All share-based compensation is currently fulfilled by purchases on the open market by our independent agents and do not dilute shareholders' ownership.

Share-Based Compensation Plans:

We have a plan that was approved by stockholders that enables us to provide a long-term incentive through equity interests in Wisconsin Energy to outside directors, selected officers and key employees of the Company. The plan provides for the granting of stock options, stock appreciation rights, restricted stock awards and performance shares. Awards may be paid in common stock, cash or a combination thereof. We utilize the straight-line attribution method for recognizing share-based compensation expense. Accordingly, for employee awards, equity classified share-based compensation cost is measured at the grant date based on the fair value of the award, and is recognized as expense over the requisite service period. There were no modifications to the terms of outstanding stock options during the period.

The following table summarizes recorded pre-tax share-based compensation expense and the related tax benefit for share-based awards made to our employees and directors as of December 31:

|                                  | <u>2009</u>           | <u>2008</u>   | <u>2007</u>    |
|----------------------------------|-----------------------|---------------|----------------|
|                                  | (Millions of Dollars) |               |                |
| Stock options                    | \$10.8                | \$12.2        | \$12.2         |
| Performance units                | 14.0                  | 9.5           | 5.4            |
| Restricted stock                 | <u>1.0</u>            | <u>1.1</u>    | <u>1.2</u>     |
| Share-based compensation expense | <u>\$25.8</u>         | <u>\$22.8</u> | <u>\$ 18.8</u> |
| Related Tax Benefit              | <u>\$10.3</u>         | <u>\$ 9.1</u> | <u>\$ 7.6</u>  |

Stock Options:

The exercise price of a stock option under the plan is to be no less than 100% of the common stock's fair market value on the grant date and options may not be exercised within six months of the grant date except in the event of a change in control. Option grants consist of non-qualified stock options and vest on a cliff-basis after a three year period. Options expire no later than ten years from the date of grant. For further information regarding stock-based compensation and the valuation of our stock options, see Note A.

Stock options to purchase 2,718,965 shares of common stock, with prices ranging from \$47.76 to \$48.04 per share were outstanding during 2009, but were not included in the computation of diluted earnings per share because they were anti-dilutive.

The following is a summary of our stock option activity during 2009:

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| Stock Options                       | Number of<br>Options | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual Life<br>(Years) | Aggregate<br>Intrinsic<br>Value<br>(Millions) |
|-------------------------------------|----------------------|------------------------------------|--|---|
| Outstanding as of January 1, 2009   | 8,543,564            | \$36.97                            |  |   |
| Granted                             | 1,216,625            | \$42.22                            |  |   |
| Exercised                           | (665,514)            | \$25.67                            |  |   |
| Forfeited                           | (7,360)              | \$46.09                            |  |   |
| Outstanding as of December 31, 2009 | <u>9,087,315</u>     | \$38.49                            | 5.9  | \$103.0                                       |
| Exercisable as of December 31, 2009 | <u>5,422,215</u>     | \$33.39                            | 4.5  | \$89.1  |

We expect that substantially all of the outstanding options as of December 31, 2009 will be exercised.

In January 2010, the Compensation Committee awarded 274,750 non-qualified stock options with an exercise price of \$49.84 to our officers and key executives under its normal schedule of awarding long-term incentive compensation.

The intrinsic value of options exercised during the years ended December 31, 2009, 2008 and 2007 was \$12.0 million, \$10.2 million and \$30.0 million, respectively. Cash received from options exercised during the years ended December 31, 2009, 2008 and 2007 was \$17.0 million, \$11.6 million and \$36.1 million, respectively. The actual tax benefit realized for the tax deductions from option exercises for the same periods was approximately \$4.8 million, \$3.5 million and \$11.2 million, respectively.

The following table summarizes information about stock options outstanding as of December 31, 2009:

|                      | Options Outstanding         |                   |  | Options Exercisable  |                   |  |
|----------------------|-----------------------------|-------------------|--|----------------------|-------------------|--|
|                      | Range of Exercise<br>Prices | Weighted-Average  |  | Number of<br>Options | Weighted-Average  |  |
| Number of<br>Options |                             | Exercise<br>Price | Remaining<br>Contractual<br>Life (Years) |                      | Exercise<br>Price | Remaining<br>Contractual<br>Life (Years) |
| \$19.62 to \$31.07   | 1,548,528                   | \$25.64           | 2.8                                      | 1,548,528            | \$25.64           | 2.8                                      |
| \$33.44 to \$39.48   | 3,593,532                   | \$35.65           | 5.0                                      | 3,593,532            | \$35.65           | 5.0                                      |
| \$42.22 to \$48.04   | 3,945,255                   | \$46.13           | 8.0                                      | 280,155              | \$47.33           | 7.2                                      |
|                      | <u>9,087,315</u>            | \$38.49           | 5.9                                      | <u>5,422,215</u>     | \$33.39           | 4.5                                      |

The following table summarizes information about our non-vested options during 2009:

| Non-Vested Stock Options         | Number<br>Of<br>Options | Weighted-<br>Average<br>Fair Value |
|----------------------------------|-------------------------|------------------------------------|
| Non-Vested as of January 1, 2009 | 3,598,379               | \$8.81                             |



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|                                    |                         |        |
|------------------------------------|-------------------------|--------|
| Granted                            | 1,216,625               | \$8.01 |
| Vested                             | (1,142,544)             | \$7.59 |
| Forfeited                          | <u>(7,360)</u>          | \$8.73 |
| Non-Vested as of December 31, 2009 | <u><u>3,665,100</u></u> | \$8.73 |

As of December 31, 2009, total compensation costs related to non-vested stock options not yet recognized was approximately \$7.4 million, which is expected to be recognized over the next 16 months on a weighted-average basis.

Restricted Shares:

The Compensation Committee has also approved restricted stock grants to certain key employees and directors. The following restricted stock activity occurred during 2009:

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| <u>Restricted Shares</u>               | <u>Number<br/>of<br/>Shares</u> | <u>Weighted-<br/>Average<br/>Market<br/>Price</u> |
|--|---------------------------------|---|
| Outstanding as of January 1, 2009      | 116,373                         |   |
| Granted                                | 14,216                          | \$42.11   |
| Released / Forfeited                   | <u>(30,940)</u>                 | \$34.84   |
| Outstanding as of December 31,<br>2009 | <u><u>99,649</u></u>            |   |

Recipients of previously issued restricted shares have the right to vote the shares and receive dividends, and the shares have vesting periods ranging up to 10 years.

In January 2010, the Compensation Committee awarded 46,740 restricted shares to our directors, officers and other key employees as part of the long-term incentive program. These awards have a three-year vesting period, with one-third of the award vesting on each anniversary of the grant date. During the vesting period, restricted share recipients also have voting rights and are entitled to dividends in the same manner as other shareholders.

We record the market value of the restricted stock awards on the date of grant and then we charge their value to expense over the vesting period of the awards. The intrinsic value of restricted stock vesting was \$0.9 million, \$2.1 million and \$2.9 million for the years ended December 31, 2009, 2008, and 2007, respectively. The actual tax benefit realized for the tax deductions from released restricted shares for the same years was \$0.3 million, \$0.5 million and \$1.1 million, respectively.

As of December 31, 2009, total compensation cost related to restricted stock not yet recognized was approximately \$1.3 million, which is expected to be recognized over the next 29 months on a weighted-average basis.

Performance Units:

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In January 2009, 2008 and 2007, the Compensation Committee awarded 333,220, 133,855 and 136,905 performance units, respectively, to officers and other key employees under the Wisconsin Energy Performance Unit Plan. Under the grants, the ultimate number of units which will be awarded is dependent upon the achievement of certain financial performance of our stock over a three-year period. Under the terms of the award, participants may earn between 0% and 175% of the base performance award. All grants are settled in cash. We are accruing compensation costs over the three-year performance period based on our estimate of the final expected value of the award. Performance units earned as of December 31, 2009, 2008 and 2007 had a total intrinsic value of \$9.8 million, \$8.4 million and \$5.2 million, respectively. The awards were subsequently distributed to our officers and key employees in January 2010, 2009 and 2008. The actual tax benefit realized for the tax deductions from the distribution of performance units was approximately \$3.4 million, \$3.1 million and \$1.8 million, respectively.

In January 2010, the Compensation Committee awarded 277,915 performance units to our officers and other key employees under its normal schedule of awarding long-term incentive compensation.

As of December 31, 2009, total compensation cost related to performance units not yet recognized was approximately \$14.4 million, which is expected to be recognized over the next 22 months on a weighted-average basis.

### Common Stock Activity:

We do not expect to issue new shares under our various employee benefit plans and our dividend reinvestment and share purchase plan; rather, we instruct independent plan agents to purchase the shares in the open market. In that regard, no new shares of common stock were issued in 2009, 2008 or 2007.

During 2009, 2008 and 2007, our plan agents purchased 0.7 million shares at a cost of \$29.6 million, 0.5 million shares at a cost of \$23.0 million and 1.4 million shares at a cost of \$67.8 million, respectively, to fulfill exercised stock options and restricted stock awards. In 2009, 2008 and 2007, we received proceeds of \$17.0 million, \$11.6 million and \$36.1 million, respectively, related to the exercise of stock options.

### Restrictions:

Wisconsin Energy's ability to pay common dividends depends on the availability of funds received from our principal utility subsidiaries, Wisconsin Electric and Wisconsin Gas. During 2009, Wisconsin Electric and Wisconsin Gas collectively provided Wisconsin Energy with \$212.6 million of dividends. In the future, as the new

PTF plants continue to be placed in service, we expect that We Power will also provide funds for Wisconsin Energy to pay dividends.

Various financing arrangements and regulatory requirements impose certain restrictions on the ability of our subsidiaries to transfer funds to Wisconsin Energy in the form of cash dividends, loans or advances. In addition, under Wisconsin law, Wisconsin Electric and Wisconsin Gas are prohibited from loaning funds, either directly or indirectly, to Wisconsin Energy.

The January 2010 PSCW rate order requires Wisconsin Electric and Wisconsin Gas to maintain capital structures that differ from GAAP as they reflect regulatory adjustments. Wisconsin Electric is required to maintain a common equity ratio range of between 48.5% and 53.5%, and Wisconsin Gas is required to maintain a capital structure which has a common equity range of between 45.0% and 50.0%. Wisconsin Electric and Wisconsin Gas must obtain PSCW approval if they pay dividends above the test year levels that would cause either company to fall below the authorized levels of common equity.

Wisconsin Electric may not pay common dividends to Wisconsin Energy under Wisconsin Electric's Restated Articles of Incorporation if any dividends on Wisconsin Electric's outstanding preferred stock have not been paid. In addition,

pursuant to the terms of Wisconsin Electric's 3.60% Serial Preferred Stock, Wisconsin Electric's ability to declare common dividends would be limited to 75% or 50% of net income during a twelve month period if Wisconsin Electric's common stock equity to total capitalization, as defined in the preferred stock designation, is less than 25% and 20%, respectively.

We have the option to defer interest payments on the Junior Notes, from time to time, for one or more periods of up to 10 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, repurchase or acquire, our common stock.

As of December 31, 2009, the restricted net assets of consolidated and unconsolidated subsidiaries and our equity in undistributed earnings of 50% or less owned investees accounted for by the equity method total approximately \$3.0 billion. This amount exceeds 25% of our consolidated net assets as of December 31, 2009.

See Note L for discussion of certain financial covenants related to the bank back-up credit facilities of Wisconsin Energy, Wisconsin Electric and Wisconsin Gas.

We do not believe that these restrictions will materially affect our operations or limit any dividend payments in the foreseeable future.

#### K -- LONG-TERM DEBT

##### Debentures and Notes:

As of December 31, 2009, the maturities and sinking fund requirements of our long-term debt outstanding (excluding obligations under capital leases) were as follows:

|            | <u>(Millions of Dollars)</u> |
|------------|------------------------------|
| 2010       | \$288.6                      |
| 2011       | 457.5                        |
| 2012       | 7.9                          |
| 2013       | 383.3                        |
| 2014       | 308.7                        |
| Thereafter | 2,603.8                      |
| Total      | <u><u>\$4,049.8</u></u>      |

We amortize debt premiums, discounts and debt issuance costs over the lives of the debt and we include the costs in interest expense.

During 2009, we issued \$261.5 million of long-term debt, including \$250 million of debentures under an existing shelf registration statement filed by Wisconsin Electric with the SEC in August 2007. The net proceeds were used to repay short-term debt and for other general corporate purposes.

Wisconsin Electric is the obligor under two series of tax-exempt pollution control refunding bonds in outstanding principal amount of \$147 million. In August 2009, Wisconsin Electric terminated letters of credit that provided credit and liquidity support for the bonds, which resulted in a mandatory tender of the bonds. Wisconsin Electric purchased the bonds at par plus accrued interest to the date of purchase. As of December 31, 2009, the repurchased bonds were still outstanding, but were reported as a reduction in our consolidated long-term debt because they are held by Wisconsin Electric. Depending on market conditions and other factors, Wisconsin Electric may change the method used to determine the interest rate on the bonds and have them remarketed to third parties.

During 2008, our subsidiaries issued \$706 million of long-term debt, including \$550 million of debentures issued by Wisconsin Electric. Of the total amount issued during 2008, \$156 million was issued by PWGS and is secured by a collateral assignment of the leases between PWGS and Wisconsin Electric related to PWGS 2. The net proceeds were used to repay short-term debt.

In addition, in December 2008, Wisconsin Energy borrowed \$260 million under an 18-month credit facility and used such amount to repay short-term debt. Similar to Wisconsin Energy's bank back-up credit facility, this agreement requires us to maintain, subject to certain exclusions, a minimum funded debt to capitalization ratio of less than 70%, and also contains customary covenants, including certain limitations on our ability to sell assets. The credit facility also contains customary events of default. In addition, Wisconsin Energy must ensure that certain of its subsidiaries comply with many of the covenants contained therein. As of December 31, 2009, Wisconsin Energy was in compliance with all covenants under the credit agreement.

During December 2008, Wisconsin Energy retired \$350.8 million of long-term debt through the issuance of short-term debt.

In connection with our outstanding Junior Notes, we executed the RCC for the benefit of persons that buy, hold or sell a specified series of long-term indebtedness (covered debt). Our 6.20% Senior Notes due April 1, 2033 have been initially designated as the covered debt under the RCC. The RCC provides that we may not redeem, defease or purchase and our subsidiaries may not purchase any Junior Notes on or before May 15, 2037, unless, subject to certain limitations described in the RCC, during the 180 days prior to the date of redemption, defeasance or purchase, we have received a specified amount of proceeds from the sale of qualifying securities.

#### Obligations Under Capital Leases:

In 1997, Wisconsin Electric entered into a 25-year power purchase contract with an unaffiliated independent power producer. The contract, for 236 MW of firm capacity from a gas-fired cogeneration facility, includes no minimum energy requirements. When the contract expires in 2022, Wisconsin Electric may, at its option and with proper notice, renew for another ten years or purchase the generating facility at fair value or allow the contract to expire. We account for this contract as a capital lease and recorded the leased facility and corresponding obligation under the capital lease at the estimated fair value of the plant's electric generating facilities. We are amortizing the leased facility on a straight-line basis over the original 25-year term of the contract.

We treat the long-term power purchase contract as an operating lease for rate-making purposes and we record our minimum lease payments as purchased power expense on the Consolidated Income Statements. We paid a total of \$29.1 million and \$28.1 million in lease payments during 2009 and 2008, respectively. We record the difference between the minimum lease payments and the sum of imputed interest and amortization costs calculated under capital lease accounting as a deferred regulatory asset on our Consolidated Balance Sheets (see Regulatory Assets - Deferred plant related -- capital lease in Note C). Due to the timing and the amounts of the minimum lease payments, the regulatory asset increased to approximately \$78.5 million during 2009, at which time the regulatory asset began to be reduced to zero over the remaining life of the contract. The total obligation under the capital lease was \$149.0 million

at December 31, 2009, and will decrease to zero over the remaining life of the contract.

Following is a summary of our capitalized leased facilities as of December 31:

| <u>Capital Lease Assets</u>            | <u>2009</u>           | <u>2008</u>   |
|--|-----------------------|---------------|
|  | (Millions of Dollars) |               |
| Leased Facilities                      |                       |               |
| Long-term power purchase<br>commitment | \$140.3               | \$140.3       |
| Accumulated amortization               | <u>(69.8)</u>         | <u>(64.1)</u> |
| Total Leased Facilities                | <u>\$70.5</u>         | <u>\$76.2</u> |

Future minimum lease payments under our capital lease and the present value of our net minimum lease payments as of December 31, 2009 are as follows:

|  | <u>(Millions of Dollars)</u> |
|--|------------------------------|
| 2010   | \$36.2                       |
| 2010   | 37.5                         |
| 2011   | 38.9                         |
| 2012   | 40.4                         |
| 2013   | 41.9                         |
| Thereafter                                     | <u>174.0</u>                 |
| Total Minimum Lease<br>Payments                | 368.9                        |
| Less: Estimated Executory<br>Costs             | <u>(87.2)</u>                |
| Net Minimum Lease Payments                     | 281.7                        |
| Less: Interest                                 | <u>(132.7)</u>               |
| Present Value of Net<br>Minimum Lease Payments | 149.0                        |
| Less: Due Currently                            | <u>(7.1)</u>                 |
|  | <u>\$141.9</u>               |

L -- SHORT-TERM DEBT

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Short-term notes payable balances and their corresponding weighted-average interest rates as of December 31 consist of:

| <u>Short-Term Debt</u>                        | <u>2009</u>    |                      | <u>2008</u>    |                      |
|---|----------------|----------------------|----------------|----------------------|
|   | <u>Balance</u> | <u>Interest Rate</u> | <u>Balance</u> | <u>Interest Rate</u> |
| (Millions of Dollars, except for percentages) |                |                      |                |                      |
| Commercial paper                              | \$820.9        | 0.28%                | \$602.3        | 4.01%                |

In addition, as of December 31, 2009, Wispark had a \$4.2 million note payable that matured in January 2010.

The following information relates to commercial paper for the years ended December 31:

|   | <u>2009</u> | <u>2008</u> |
|---|-------------|-------------|
| (Millions of Dollars, except for percentages) |             |             |
| Maximum Short-Term Debt Outstanding           | \$1,058.8   | \$1,114.7   |
| Average Short-Term Debt Outstanding           | \$819.6     | \$875.1     |
| Weighted-Average Interest Rate                | 0.57 %      | 3.26%       |

Wisconsin Energy, Wisconsin Electric and Wisconsin Gas have entered into various bank back-up credit facilities to maintain short-term credit liquidity which, among other terms, require the companies to maintain, subject to certain exclusions, a minimum total funded debt to capitalization ratio of less than 70%, 65% and 65%, respectively.

An affiliate of Lehman Brothers Holdings, which filed for bankruptcy in September 2008, provided approximately \$80 million of commitments under our bank back-up facilities on a consolidated basis. As of December 31, 2009, excluding Lehman's commitments, we had approximately \$1.6 billion of available undrawn lines under our bank back-up credit facilities on a consolidated basis. As of December 31, 2009, we had approximately \$820.9 million of commercial paper outstanding on a consolidated basis that was supported by the available lines of credit. Wisconsin Electric's and Wisconsin Gas' bank back-up credit facilities expire in March 2011 and Wisconsin Energy's expires in April 2011, but may be renewed for two one-year extensions, subject to lender approval.

The Wisconsin Energy, Wisconsin Electric and Wisconsin Gas bank back-up credit facilities contain customary covenants, including certain limitations on the respective companies' ability to sell assets. The credit facilities also contain customary events of default, including payment defaults, material inaccuracy of representations and warranties, covenant defaults, bankruptcy proceedings, certain judgments, ERISA defaults and change of control. In

addition, pursuant to the terms of Wisconsin Energy's credit agreement, Wisconsin Energy must ensure that certain of its subsidiaries comply with many of the covenants contained therein.

As of December 31, 2009, we were in compliance with all covenants.

## M -- DERIVATIVE INSTRUMENTS

We utilize derivatives as part of our risk management program to manage the volatility and costs of purchased power, generation and natural gas purchases for the benefit of our customers and shareholders. Our approach is non-speculative and designed to mitigate risk and protect against price volatility. Regulated hedging programs require prior approval by the PSCW.

We record derivative instruments on the balance sheet as an asset or liability measured at its fair value, and changes in the derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met or we receive regulatory treatment for the derivative. For most energy related physical and financial contracts in our regulated operations that qualify as derivatives, the PSCW allows the effects of the fair market value accounting to be offset to regulatory assets and liabilities. We do not offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivatives executed with the same counterparty under the same master netting arrangement. As of December 31, 2009, we recognized \$19.1 million in regulatory assets and \$10.3 million in regulatory liabilities related to derivatives in comparison to \$84.4 million in regulatory assets and \$11.9 million in regulatory liabilities as of December 31, 2008.

We record our current derivative assets on the balance sheet in Prepayments and other current assets and the current portion of the liabilities in Other current liabilities. The long-term portion of our derivative assets of \$0.8 million is recorded in Other deferred charges and other assets and the long-term portion of our derivative liabilities of \$5.3 million is recorded in Other deferred credits and other liabilities. Our Consolidated Balance Sheet as of December 31, 2009 includes:

|             | <u>Derivative<br/>Asset</u> | <u>Derivative<br/>Liability</u> |
|-------------|-----------------------------|---------------------------------|
|             | (Millions of Dollars)       |                                 |
| Natural Gas | \$2.2                       | \$9.3                           |
| Fuel Oil    | 0.6                         | -                               |
| FTRs        | 5.9                         | -                               |
| Coal        | 2.1                         | -                               |
| Total       | <u>\$10.8</u>               | <u>\$9.3</u>                    |

Our Consolidated Income Statements include gains (losses) on derivative instruments used in our risk management strategies for those commodities supporting our electric operations and natural gas sold to our customers. Our estimated notional volumes and gain (losses) for the year ended December 31, 2009 were as follows:

(Millions of Dollars)

|             |                     |                 |
|-------------|---------------------|-----------------|
| Natural Gas | 87.8 million Dth    | (\$97.9)        |
| Energy      | 23,520.0 MWh        | (0.5)           |
| Fuel Oil    | 6.8 million gallons | (2.5)           |
| FTRs        | 27,561.8 MW         | 13.3            |
| Total       |                     | <u>(\$87.6)</u> |

As of December 31, 2009, we have posted collateral of \$9.3 million in our margin accounts.

For the years ended December 31, 2009, 2008 and 2007, we reclassified \$0.4 million, \$0.4 million and \$0.3 million, respectively, in treasury lock agreement settlement payments deferred in Accumulated Other Comprehensive Income, as an increase to Interest Expense. We estimate that during the next 12 months, \$0.4 million will be reclassified from Accumulated Other Comprehensive Income as a reduction in earnings.

## N -- FAIR VALUE MEASUREMENTS

Fair value measurements require enhanced disclosures about assets and liabilities that are measured and reported at fair value and establish a hierarchal disclosure framework which prioritizes and ranks the level of observable inputs used in measuring fair value.

Fair value is the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). We primarily apply the market approach for recurring fair value measurements and attempt to utilize the best available information. Accordingly, we also utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. We are able to classify fair value balances based on the observability of those inputs. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

Assets and liabilities measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1 -- Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Instruments in this category consist of financial instruments such as exchange-traded derivatives, cash equivalents and restricted cash investments.

Level 2 -- Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Instruments in this category include non-exchange-traded derivatives such as OTC forwards and options.

Level 3 -- Pricing inputs include significant inputs that are generally less observable from objective sources. The inputs in the determination of fair value require significant management judgment or estimation. At each balance sheet date, we perform an analysis of all instruments subject to fair value reporting and include in Level 3 all instruments whose fair value is based on significant unobservable inputs.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the



fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the instrument.

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The following table summarizes our financial assets and liabilities by level within the fair value hierarchy:

| Recurring Fair Value Measures | As of December 31, 2009 |         |         | Total   |
|-------------------------------|-------------------------|---------|---------|---------|
|                               | Level 1                 | Level 2 | Level 3 |         |
|                               | (Millions of Dollars)   |         |         |         |
| Assets:                       |                         |         |         |         |
| Restricted Cash               | \$194.5                 | \$ -    | \$ -    | \$194.5 |
| Derivatives                   | 0.7                     | 4.2     | 5.9     | 10.8    |
| Total                         | \$195.2                 | \$4.2   | \$5.9   | \$205.3 |
| Liabilities:                  |                         |         |         |         |
| Derivatives                   | \$4.5                   | \$4.8   | \$ -    | \$9.3   |
| Total                         | \$4.5                   | \$4.8   | \$ -    | \$9.3   |

| Recurring Fair Value Measures | As of December 31, 2008 |         |         | Total   |
|-------------------------------|-------------------------|---------|---------|---------|
|                               | Level 1                 | Level 2 | Level 3 |         |
|                               | (Millions of Dollars)   |         |         |         |
| Assets:                       |                         |         |         |         |
| Cash Equivalents              | \$9.1                   | \$ -    | \$ -    | \$9.1   |
| Restricted Cash               | 386.5                   | -       | -       | 386.5   |
| Derivatives                   | -                       | 4.2     | 8.8     | 13.0    |
| Total                         | \$395.6                 | \$4.2   | \$8.8   | \$408.6 |
| Liabilities:                  |                         |         |         |         |
| Derivatives                   | \$38.9                  | \$32.1  | \$ -    | \$71.0  |
| Total                         | \$38.9                  | \$32.1  | \$ -    | \$71.0  |

Cash Equivalents consist of certificates of deposit and money market funds. Restricted cash consists of certificates of deposit and government backed interest bearing securities and represents the remaining funds to be distributed to customers resulting from the net proceeds received from the sale of Point Beach. Derivatives reflect positions we hold in exchange-traded derivative contracts and OTC derivative contracts. Exchange-traded derivative contracts, which include futures and exchange-traded options, are generally based on unadjusted quoted prices in active markets and are classified within Level 1. Some OTC derivative contracts are valued using broker or dealer quotations, or market transactions in either the listed or OTC markets utilizing a mid-market pricing convention (the mid-point between bid and ask prices), as appropriate. In such cases, these derivatives are classified within Level 2. Certain OTC derivatives may utilize models to measure fair value. Generally, we use a similar model to value similar instruments. Valuation models utilize various inputs which include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, other observable inputs for the asset or liability, and market-corroborated inputs (i.e., inputs derived principally from or corroborated by observable market

data by correlation or other means). Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. Certain OTC derivatives are in less active markets with a lower availability of pricing information which might not be observable in or corroborated by the market. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized in Level 3.

The following table summarizes the fair value of derivatives classified as Level 3 in the fair value hierarchy:

|  | <u>2009</u>           | <u>2008</u>  |
|--|-----------------------|--------------|
|  | (Millions of Dollars) |              |
| Balance as of January 1  | \$8.8                 | \$13.0       |
| Realized and unrealized gains (losses)   | -                     | -            |
| Purchases, issuances and settlements   | (2.9)                 | (4.2)        |
| Transfers in and/or out of Level 3   | -                     | -            |
| Balance as of December 31  | <u>\$5.9</u>          | <u>\$8.8</u> |
| Change in unrealized gains (losses) relating to instruments still held as of December 31 | \$ -                  | \$ -         |

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Derivative instruments reflected in Level 3 of the hierarchy include MISO FTRs that are measured at fair value each reporting period using monthly or annual auction shadow prices from relevant auctions. Changes in fair value for Level 3 recurring items are recorded on our balance sheet. See Note M -- Derivative Instruments, for further information on the offset to regulatory assets and liabilities.

The carrying amount and estimated fair value of certain of our recorded financial instruments as of December 31 are as follows:

| <u>Financial Instruments</u>             | <u>2009</u>            |                   | <u>2008</u>            |                   |
|--|------------------------|-------------------|------------------------|-------------------|
|  | <u>Carrying Amount</u> | <u>Fair Value</u> | <u>Carrying Amount</u> | <u>Fair Value</u> |
|  | (Millions of Dollars)  |                   |                        |                   |
| Preferred stock, no redemption required  | \$30.4                 | \$20.2            | \$30.4                 | \$19.0            |
| Long-term debt including current portion | \$4,049.8              | \$4,162.5         | \$4,009.4              | \$3,711.9         |

The carrying value of net accounts receivable, accounts payable and short-term borrowings approximates fair value due to the short-term nature of these instruments. The fair value of our preferred stock is estimated based upon the quoted market value for the same or similar issues. The fair value of our long-term debt, including the current portion of long-term debt, but excluding capitalized leases and unamortized discount debt, is estimated based upon quoted

market value for the same or similar issues or upon the quoted market prices of U.S. Treasury issues having a similar term to maturity, adjusted for the issuing company's bond rating and the present value of future cash flows.

## O -- BENEFITS

### Pensions and Other Post-retirement Benefits:

We have defined benefit pension plans that cover substantially all of our employees. The plans provide defined benefits based upon years of service and final average salary.

We also have OPEB plans covering substantially all of our employees. The health care plans are contributory with participants' contributions adjusted annually; the life insurance plans are noncontributory. The accounting for the health care plans anticipates future cost-sharing changes to the written plans that are consistent with our expressed intent to maintain the current cost sharing levels. The post-retirement health care plans include a limit on our share of costs for recent and future retirees.

We use a year-end measurement date to measure the funded status of all of our pension and OPEB plans. Due to the regulated nature of our business, we have concluded that substantially all of the unrecognized costs resulting from the recognition of the funded status of our pension and OPEB plans qualify as a regulatory asset.

The following table presents details about our pension and OPEB plans:

|                                   | Pension               |           | OPEB    |         |
|-----------------------------------|-----------------------|-----------|---------|---------|
|                                   | 2009                  | 2008      | 2009    | 2008    |
|                                   | (Millions of Dollars) |           |         |         |
| Change in Benefit Obligation      |                       |           |         |         |
| Benefit Obligation at January 1   | \$1,140.0             | \$1,161.0 | \$324.6 | \$331.0 |
| Service cost                      | 23.3                  | 17.5      | 8.7     | 10.3    |
| Interest cost                     | 72.3                  | 71.1      | 20.5    | 20.0    |
| Plan participants' contributions  | -                     | -         | 6.6     | -       |
| Plan amendments                   | 0.2                   | 5.9       | (9.2)   | 0.3     |
| Actuarial loss (gain)             | 40.6                  | (29.1)    | 43.7    | (26.9)  |
| Gross benefits paid               | (115.7)               | (86.4)    | (21.3)  | (11.4)  |
| Federal subsidy on benefits paid  | N/A                   | N/A       | 1.1     | 1.3     |
| Benefit Obligation at December 31 | \$1,160.7             | \$1,140.0 | \$374.7 | \$324.6 |

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|                                       | Pension               |                | OPEB           |                |
|---------------------------------------|-----------------------|----------------|----------------|----------------|
|                                       | 2009                  | 2008           | 2009           | 2008           |
|                                       | (Millions of Dollars) |                |                |                |
| Change in Plan Assets                 |                       |                |                |                |
| Fair Value at January 1               | \$719.2               | \$1,007.2      | \$158.7        | \$201.5        |
| Actual earnings (loss) on plan assets | 146.7                 | (247.1)        | 34.3           | (54.3)         |
| Employer contributions                | 275.8                 | 45.5           | 24.3           | 22.9           |
| Plan participants contributions       | -                     | -              | 6.6            | -              |
| Gross benefits paid                   | (115.7)               | (86.4)         | (21.3)         | (11.4)         |
| Fair Value at December 31             | <u>1,026.0</u>        | <u>719.2</u>   | <u>202.6</u>   | <u>158.7</u>   |
| Net Liability                         | <u>\$134.7</u>        | <u>\$420.8</u> | <u>\$172.1</u> | <u>\$165.9</u> |

Amounts recognized in our Consolidated Balance Sheets as of December 31 related to the funded status of the benefit plans consisted of:

|                             | Pension               |                | OPEB           |                |
|-----------------------------|-----------------------|----------------|----------------|----------------|
|                             | 2009                  | 2008           | 2009           | 2008           |
|                             | (Millions of Dollars) |                |                |                |
| Other deferred charges      | \$ -                  | \$ -           | \$ 13.0        | \$ 48.5        |
| Other current liabilities   | 0.1                   | 0.1            | 0.2            | 0.1            |
| Other long-term liabilities | 134.6                 | 420.7          | 184.9          | 214.3          |
| Net liability               | <u>\$134.7</u>        | <u>\$420.8</u> | <u>\$172.1</u> | <u>\$165.9</u> |

The accumulated benefit obligation for all defined benefit plans was \$1,145.1 million and \$1,117.2 million as of December 31, 2009 and 2008, respectively.

The following table shows the amounts that have not yet been recognized in our net periodic benefit cost as of December 31 and are recorded as a regulatory asset on our balance sheet:

|                               | Pension               |         | OPEB    |         |
|-------------------------------|-----------------------|---------|---------|---------|
|                               | 2009                  | 2008    | 2009    | 2008    |
|                               | (Millions of Dollars) |         |         |         |
| Net actuarial loss            | \$537.8               | \$567.4 | \$144.4 | \$130.2 |
| Prior service costs (credits) | 19.2                  | 21.3    | (20.9)  | (24.2)  |
| Transition obligation         | -                     | -       | 1.0     | 1.3     |

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|       |                |                |                |                |
|-------|----------------|----------------|----------------|----------------|
| Total | <u>\$557.0</u> | <u>\$588.7</u> | <u>\$124.5</u> | <u>\$107.3</u> |
|-------|----------------|----------------|----------------|----------------|

The following table shows the estimated amounts that will be amortized as a component of net periodic benefit costs during 2010:

|                                  | <u>Pension</u>        | <u>OPEB</u>    |
|----------------------------------|-----------------------|----------------|
|                                  | (Millions of Dollars) |                |
| Net actuarial loss               | \$26.7                | \$10.6         |
| Prior service costs<br>(credits) | 2.3                   | (11.8)         |
| Transition obligation            | <u>-</u>              | <u>0.3</u>     |
| Total                            | <u>\$29.0</u>         | <u>(\$0.9)</u> |

Information for pension plans with an accumulated benefit obligation in excess of the fair value of assets as of December 31 is as follows:

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|                                | <u>2009</u>           | <u>2008</u> |
|--------------------------------|-----------------------|-------------|
|                                | (Millions of Dollars) |             |
| Projected benefit obligation   | \$1,160.7             | \$1,140.0   |
| Accumulated benefit obligation | \$1,145.1             | \$1,117.2   |
| Fair value of plan assets      | \$1,026.0             | \$719.2     |

The components of net periodic pension and OPEB costs for the years ended December 31 are as follows:

|                                | <u>Pension</u>        |             |             | <u>OPEB</u> |             |             |
|--------------------------------|-----------------------|-------------|-------------|-------------|-------------|-------------|
|                                | <u>2009</u>           | <u>2008</u> | <u>2007</u> | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|                                | (Millions of Dollars) |             |             |             |             |             |
| Net Periodic Benefit Cost      |                       |             |             |             |             |             |
| Service cost                   | \$23.3                | \$17.5      | \$29.5      | \$8.7       | \$10.3      | \$11.2      |
| Interest cost                  | 72.3                  | 71.1        | 71.2        | 20.5        | 20.0        | 19.2        |
| Expected return on plan assets | (95.4)                | (84.7)      | (83.9)      | (13.6)      | (17.5)      | (15.5)      |
| Amortization of:               |                       |             |             |             |             |             |
| Transition obligation          | -                     | -           | -           | 0.3         | 0.3         | 0.3         |
| Prior service cost (credit)    | 2.2                   | 2.5         | 5.5         | (12.6)      | (12.6)      | (12.5)      |
| Actuarial loss                 | <u>18.9</u>           | <u>16.3</u> | <u>15.8</u> | <u>8.9</u>  | <u>6.0</u>  | <u>7.1</u>  |

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|                           |               |               |               |               |              |              |
|---------------------------|---------------|---------------|---------------|---------------|--------------|--------------|
| Net Periodic Benefit Cost | <u>\$21.3</u> | <u>\$22.7</u> | <u>\$38.1</u> | <u>\$12.2</u> | <u>\$6.5</u> | <u>\$9.8</u> |
|---------------------------|---------------|---------------|---------------|---------------|--------------|--------------|

Weighted-Average assumptions used to determine benefit obligations as of Dec. 31

|                               |       |      |            |       |      |       |
|-------------------------------|-------|------|------------|-------|------|-------|
| Discount rate                 | 6.05% | 6.5% | 6.05%      | 5.75% | 6.5% | 6.10% |
| Rate of compensation increase | 4.0   | 4.0  | 4.5 to 5.0 | N/A   | N/A  | N/A   |

Weighted-Average assumptions used to determine net cost for year ended Dec. 31

|                                |      |            |            |      |       |       |
|--------------------------------|------|------------|------------|------|-------|-------|
| Discount rate                  | 6.5% | 6.05%      | 5.75%      | 6.5% | 6.10% | 5.75% |
| Expected return on plan assets | 8.25 | 8.5        | 8.5        | 8.25 | 8.5   | 8.5   |
| Rate of compensation increase  | 4.0  | 4.5 to 5.0 | 4.5 to 5.0 | N/A  | N/A   | N/A   |

Assumed health care cost trend rates as of Dec. 31

|  |           |       |      |
|--|-----------|-------|------|
| Health care cost trend rate assumed for next year (Pre 65/Post 65) | 7.5/20    | 7.5/9 | 8/11 |
| Rate that the cost trend rate gradually adjusts to                 | 5         | 5     | 5    |
| Year that the rate reaches the rate it is assumed to remain at     | 2015/2016 | 2014  | 2014 |

The expected long-term rate of return on plan assets was 8.25% in 2009, and 8.5% in 2008 and 2007. Subsequent to our last asset/liability study in 2005, we have consulted with our investment advisors on an annual basis and requested them to forecast expected long-term returns on plan assets by reviewing historical returns as well as calculating expected total trust returns using the weighted-average of long-term market returns for each of the major target asset categories utilized in the fund.

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

|   | <u>1% Increase</u>    | <u>1% Decrease</u> |
|---|-----------------------|--------------------|
|   | (Millions of Dollars) |                    |
| Effect on                                     |                       |                    |
| Post-retirement benefit obligation            | \$28.0                | (\$23.6)           |
| Total of service and interest cost components | \$3.7                 | (\$3.0)            |

We use various Employees' Benefit Trusts to fund a major portion of OPEB. The majority of the trusts' assets are

mutual funds or commingled funds.

Plan Assets:

Current pension trust assets and amounts which are expected to be contributed to the trusts in the future will be adequate to meet pension payment obligations to current and future retirees.

The Investment Trust Policy Committee oversees investment matters related to all of our funded benefit plans. The Committee works with external actuaries and investment consultants on an ongoing basis to establish and monitor investment strategies and target asset allocations. Forecasted cash flows for plan liabilities are regularly updated based on annual valuation results. Target allocations are determined utilizing projected benefit payment cash flows and risk analyses of appropriate investments. They are intended to reduce risk, provide long-term financial stability for the plans and maintain funded levels which meet long-term plan obligations while preserving sufficient liquidity for near-term benefit payments.

Our current pension plan asset allocation is 45% equity investments and 55% fixed income investments. The current OPEB asset allocation is 60% equity investments and 40% fixed income investments. Equity securities include investments in large-cap, mid-cap and small-cap companies primarily located in the United States. Fixed income securities include corporate bonds of companies from diversified industries, mortgage and other asset backed securities, commercial paper, and U.S. Treasuries.

The following table summarizes the fair value of our pension plan assets as of December 31, 2009 by asset category within the fair value hierarchy (for further level information, see Note N):

| <u>Asset Category - Pension</u>             | <u>Level 1</u>        | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u>     |
|---|-----------------------|----------------|----------------|------------------|
|   | (Millions of Dollars) |                |                |                  |
| Cash and Cash Equivalents                   | \$10.7                | \$ -           | \$ -           | \$10.7           |
| Equities:                                   |                       |                |                |                  |
| U.S. Equity                                 | 183.5                 | 215.9          | -              | 399.4            |
| International Equity                        | 58.6                  | 33.7           | -              | 92.3             |
| Fixed Income                                |                       |                |                |                  |
| Short, Intermediate and Long-term Bonds (a) |                       |                |                |                  |
| U.S. Bonds                                  | 448.9                 | -              | -              | 448.9            |
| International Bonds                         | 43.5                  | -              | -              | 43.5             |
| Commercial Paper (b)                        | 31.2                  | -              | -              | 31.2             |
| Total                                       | <u>\$776.4</u>        | <u>\$249.6</u> | <u>\$ -</u>    | <u>\$1,026.0</u> |

- (a) This category represents investment grade bonds of U.S. and foreign issuers denominated in U.S. dollars from diverse industries.
- (b) This category represents investment in commercial paper issued by Wisconsin Energy.

The following table summarizes the fair value of our OPEB plan assets as of December 31, 2009 by asset category within the fair value hierarchy:

| <u>Asset Category - OPEB</u>            | <u>Level 1</u>        | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u>   |
|---|-----------------------|----------------|----------------|----------------|
|   | (Millions of Dollars) |                |                |                |
| Cash and Cash Equivalents               | \$0.8                 | \$ -           | \$ -           | \$0.8          |
| Equities:                               |                       |                |                |                |
| U.S. Equity                             | 37.5                  | 72.8           | -              | 110.3          |
| International Equity                    | 3.5                   | 2.0            | -              | 5.5            |
| Fixed Income:                           |                       |                |                |                |
| Short, Intermediate and Long-term Bonds |                       |                |                |                |
| (a)                                     |                       |                |                |                |
| U.S. Bonds                              | 81.6                  | -              | -              | 81.6           |
| International Bonds                     | 2.6                   | -              | -              | 2.6            |
| Commercial Paper (b)                    | 1.8                   | -              | -              | 1.8            |
| Total                                   | <u>\$127.8</u>        | <u>\$74.8</u>  | <u>\$ -</u>    | <u>\$202.6</u> |

(a) This category represents investment grade bonds of U.S. and foreign issuers denominated in U.S. dollars from diverse industries.

(b) This category represents investment in commercial paper issued by Wisconsin Energy.

In January 2009, the committee that oversees the investment of the pension assets authorized the Trustee of our pension plan to invest in the commercial paper of Wisconsin Energy. As of December 31, 2009, the Pension Trust and OPEB plan assets included approximately \$33 million of commercial paper issued by Wisconsin Energy, which represents less than 10% of total assets of the plan.

Cash Flows:

| <u>Employer Contributions</u> | <u>Pension</u>        | <u>OPEB</u> |
|-------------------------------|-----------------------|-------------|
|                               | (Millions of Dollars) |             |
| 2007                          | \$26.7                | \$2.5       |
| 2008                          | \$45.5                | \$22.9      |
| 2009                          | \$275.8               | \$24.3      |

Of the amounts listed above, we contributed \$270 million, \$38.6 million and \$20.0 million to our qualified pension plan during 2009, 2008 and 2007, respectively. We do not expect to make contributions to the plan in 2010.

Future contributions to the plans will be dependent upon many factors, including the performance of existing plan



assets and long-term discount rates.

The entire contribution to the OPEB plans during 2009 was discretionary as the plans are not subject to any minimum regulatory funding requirements.

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The following table identifies our expected benefit payments over the next 10 years:

| Year                  | Pension | Gross<br>OPEB | Expected<br>Medicare<br>Part D<br>Subsidy |
|-----------------------|---------|---------------|---|
| (Millions of Dollars) |         |               |   |
| 2010                  | \$83.8  | \$20.6        | (\$1.0)                                   |
| 2011                  | \$100.4 | \$22.2        | (\$0.7)                                   |
| 2012                  | \$108.2 | \$23.5        | \$ -                                      |
| 2013                  | \$107.8 | \$25.7        | \$ -                                      |
| 2014                  | \$111.3 | \$26.8        | \$ -                                      |
| 2015-2019             | \$539.8 | \$149.8       | \$ -                                      |

#### Savings Plans:

We sponsor savings plans which allow employees to contribute a portion of their pre-tax and or after-tax income in accordance with plan-specified guidelines. Under these plans we expensed matching contributions of \$14.1 million, \$14.8 million and \$12.1 million during 2009, 2008 and 2007, respectively.

#### P -- GUARANTEES

We enter into various guarantees to provide financial and performance assurance to third parties on behalf of our affiliates. As of December 31, 2009, we had the following guarantees:

| Maximum<br>Potential Future<br>Payments | Outstanding as of<br>December 31,<br>2009 | Liability Recorded<br>as of December 31,<br>2009 |
|---|---|--|
| (Millions of Dollars)                   |   |  |
| \$3.1                                   | \$0.3                                     | \$ -   |

A non-utility energy segment guarantee in support of Wisvest-Connecticut, which we sold in December 2002 to PSEG, provides financial assurance for potential obligations relating to environmental remediation under the original purchase agreement for Wisvest-Connecticut with The United Illuminating Company. The potential obligations for

environmental remediation, which are unlimited, are reimbursable by PSEG under the terms of the sale agreement in the event that we are required to perform under the guarantee.

We also provide guarantees to support obligations of our affiliates to third parties under loan agreements and surety bonds. In the event our affiliates fail to perform, we would be responsible for the obligations.

Wisconsin Electric is subject to the potential retrospective premiums that could be assessed under its insurance program.

Postemployment benefits:

Postemployment benefits provided to former or inactive employees are recognized when an event occurs. The estimated liability for such benefits was \$15.8 million as of December 31, 2009.

Q -- SEGMENT REPORTING

Our reportable operating segments at December 31, 2009 include a utility energy segment and a non-utility energy segment. We have organized our reportable operating segments based upon the regulatory environment in which our utility subsidiaries operate and on how management makes decisions and measures performance. The segments are managed separately because each business requires different technology and marketing strategies. The accounting policies of the reportable operating segments are the same as those described in Note A.

Our utility energy segment primarily includes our electric and natural gas utility operations. Our electric utility operation engages in the generation, distribution and sale of electric energy in southeastern (including metropolitan Milwaukee), east central and northern Wisconsin and in the Upper Peninsula of Michigan. Our natural gas utility operation is engaged in the purchase, distribution and sale of natural gas to retail customers and the transportation of

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customer-owned natural gas throughout Wisconsin. Our non-utility energy segment derives its revenues primarily from the ownership of electric power generating facilities for long-term lease to Wisconsin Electric.

Summarized financial information concerning our reportable operating segments for each of the three years ended December 31, 2009 is shown in the following table. The segment information below includes income from discontinued operations as a result of the sale of the water utility in April 2009.

| Year Ended            | Reportable Operating Segments |             | Corporate & Other (a) & | Total Consolidated |
|-----------------------|-------------------------------|-------------|-------------------------|--------------------|
|                       | Energy                        |             | Reconciling             |                    |
|                       | Utility                       | Non-Utility | Eliminations            |                    |
| (Millions of Dollars) |                               |             |                         |                    |

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|   |            |           |           |            |
|---|------------|-----------|-----------|------------|
| Operating Revenues (b)                          | \$4,119.3  | \$163.1   | (\$154.5) | \$4,127.9  |
| Depreciation, Decommissioning and Amortization  | \$316.2    | \$29.2    | \$0.7     | \$346.1    |
| Operating Income (Loss)                         | \$554.3    | \$120.1   | (\$10.7)  | \$663.7    |
| Equity in Earnings of Unconsolidated Affiliates | \$59.1     | \$ -      | (\$0.2)   | \$58.9     |
| Interest Expense, Net                           | \$117.5    | \$14.7    | \$24.5    | \$156.7    |
| Income Tax Expense (Benefit)                    | \$188.5    | \$43.4    | (\$14.6)  | \$217.3    |
| Income from Discontinued Operations, Net of Tax | \$0.3      | \$ -      | \$4.9     | \$5.2      |
| Net Income (Loss)                               | \$334.2    | \$63.8    | (\$15.6)  | \$382.4    |
| Capital Expenditures                            | \$550.1    | \$253.2   | \$14.4    | \$817.7    |
| Total Assets (c)                                | \$10,784.6 | \$2,754.1 | (\$840.8) | \$12,697.9 |

December 31, 2008

|   |            |           |           |            |
|---|------------|-----------|-----------|------------|
| Operating Revenues (b)                          | \$4,421.3  | \$126.2   | (\$119.7) | \$4,427.8  |
| Depreciation, Decommissioning and Amortization  | \$303.8    | \$21.9    | \$0.8     | \$326.5    |
| Operating Income (Loss)                         | \$580.5    | \$89.3    | (\$10.6)  | \$659.2    |
| Equity in Earnings of Unconsolidated Affiliates | \$51.8     | \$ -      | (\$0.5)   | \$51.3     |
| Interest Expense, Net                           | \$107.2    | \$12.0    | \$34.5    | \$153.7    |
| Income Tax Expense (Benefit)                    | \$202.9    | \$32.5    | (\$18.9)  | \$216.5    |
| Income from Discontinued Operations, Net of Tax | \$0.8      | \$ -      | \$0.5     | \$1.3      |
| Net Income (Loss)                               | \$334.1    | \$48.6    | (\$23.6)  | \$359.1    |
| Capital Expenditures                            | \$606.7    | \$529.3   | \$0.4     | \$1,136.4  |
| Total Assets (c)                                | \$10,791.6 | \$2,516.7 | (\$690.5) | \$12,617.8 |

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| Year Ended | Reportable Operating Segments |             | Corporate & Other (a) &  | Total Consolidated |
|------------|-------------------------------|-------------|--------------------------|--------------------|
|            | Utility                       | Non-Utility | Reconciling Eliminations |                    |

(Millions of Dollars)

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December 31, 2007

|   |            |           |           |            |
|---|------------|-----------|-----------|------------|
| Operating Revenues (b)                                    | \$4,222.1  | \$75.7    | (\$62.7)  | \$4,235.1  |
| Depreciation, Decommissioning and Amortization            | \$314.9    | \$12.1    | \$0.9     | \$327.9    |
| Operating Income (Loss)                                   | \$584.7    | \$47.4    | (\$4.9)   | \$627.2    |
| Equity in Earnings of Unconsolidated Affiliates           | \$43.1     | \$ -      | \$0.9     | \$44.0     |
| Interest Expense, net                                     | \$113.8    | \$7.4     | \$46.4    | \$167.6    |
| Income Tax Expense (Benefit)                              | \$220.7    | \$14.3    | (\$19.1)  | \$215.9    |
| Income (Loss) from Discontinued Operations,<br>Net of Tax | \$0.8      | \$ -      | (\$0.9)   | (\$0.1)    |
| Net Income (Loss)   | \$338.0    | \$23.7    | (\$26.1)  | \$335.6    |
| Capital Expenditures                                      | \$539.0    | \$669.3   | \$1.9     | \$1,210.2  |
| Total Assets (c)  | \$10,243.7 | \$1,974.5 | (\$497.9) | \$11,720.3 |

- (a) Other includes all other non-utility activities, primarily non-utility real estate investment and development by Wispark as well as interest on corporate debt.
- (b) An elimination for intersegment revenues of \$154.8 million, \$119.0 million and \$70.3 million is included in Operating Revenues for 2009, 2008 and 2007, respectively. This elimination is primarily between We Power and Wisconsin Electric.
- (c) An elimination of \$889.1 million, \$794.0 million and \$465.4 million is included in Total Assets at December 31, 2009, 2008 and 2007, respectively, for all PTF-related activity between We Power and Wisconsin Electric.

R -- RELATED PARTIES

We receive and/or provide certain services to other associated companies in which we have an equity investment.

American Transmission Company LLC:

As of December 31, 2009, we have a 26.2% interest in ATC. We pay ATC for transmission and other related services it provides. In addition, we provide a variety of operational, maintenance and project management work for ATC, which are reimbursed to us by ATC. We are required to pay the cost of needed transmission infrastructure upgrades for new generation projects while projects are under construction, including generating units being constructed as part of our PTF strategy. ATC will reimburse us for these costs when new generation is placed into service. As of December 31, 2009 and 2008, we had a receivable of \$1.1 million and \$32.6 million, respectively, for these items.

Nuclear Management Company:

Prior to the Point Beach sale, we had a partial ownership in NMC, which held the operating licenses of Point Beach. Upon the sale of Point Beach, the operating licenses were transferred to the buyer and our relationship with NMC was

terminated.

We provided and received services from the following associated companies during 2009, 2008 and 2007:

| <u>Equity Investee</u> | <u>2009</u>           | <u>2008</u> | <u>2007</u> |
|------------------------|-----------------------|-------------|-------------|
|                        | (Millions of Dollars) |             |             |
| Services Provided      |                       |             |             |
| -ATC                   | \$22.9                | \$20.7      | \$17.8      |
| Services Received      |                       |             |             |
| -ATC                   | \$201.3               | \$199.4     | \$176.8     |
| -NMC                   | \$ -                  | \$ -        | \$50.6      |

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As of December 31, 2009 and 2008, our Consolidated Balance Sheets included receivable and payable balances with ATC as follows:

| <u>Equity Investee</u> | <u>2009</u>           | <u>2008</u> |
|------------------------|-----------------------|-------------|
|                        | (Millions of Dollars) |             |
| Services Provided      |                       |             |
| -ATC                   | \$1.1                 | \$2.1       |
| Services Received      |                       |             |
| -ATC                   | \$16.7                | \$16.6      |

## S -- COMMITMENTS AND CONTINGENCIES

### Capital Expenditures:

We have made certain commitments in connection with 2010 capital expenditures. During 2010, we estimate that total capital expenditures will be approximately \$950.5 million.

### Operating Leases:

We enter into long-term purchase power contracts to meet a portion of our anticipated increase in future electric energy supply needs. These contracts expire at various times through 2014. Certain of these contracts were deemed to qualify as operating leases. In addition, we have various other operating leases including leases for vehicles and coal cars.

Future minimum payments for the next five years and thereafter for our operating lease contracts are as follows:

|            | <u>(Millions of Dollars)</u> |
|------------|------------------------------|
| 2010       | \$21.3                       |
| 2011       | 21.5                         |
| 2012       | 15.1                         |
| 2013       | 5.5                          |
| 2014       | 2.9                          |
| Thereafter | 9.7                          |
| Total      | <u>\$76.0</u>                |

#### Divested Assets:

Pursuant to the sale of Point Beach, we have agreed to indemnification provisions customary to transactions involving the sale of nuclear assets.

Pursuant to the terms of the sales agreement for the manufacturing business, Wisconsin Energy agreed to customary indemnification provisions related to certain environmental, asbestos, and product liability matters. In addition, the amount of cash taxes and future deferred income tax benefits are subject to a number of factors including appraisals of the fair value of Wisconsin Gas assets and applicable tax laws. Any changes in the estimates of taxes and indemnification matters will be recorded as an adjustment to the gain on sale and reported in discontinued operations in the period the adjustment is determined. We have established reserves related to these customary indemnification and tax matters.

#### Environmental Matters:

We periodically review our exposure for environmental remediation costs as evidence becomes available indicating that our liability has changed. Given current information, including the following, we believe that future costs in excess of the amounts accrued and/or disclosed on all presently known and quantifiable environmental contingencies will not be material to our financial position or results of operations.

We have a program of comprehensive environmental remediation planning for former manufactured gas plant sites and coal-ash disposal sites. We perform ongoing assessments of manufactured gas plant sites and related disposal sites used by Wisconsin Electric and Wisconsin Gas, and coal ash disposal/landfill sites used by Wisconsin Electric, as discussed below. We are working with the WDNR in our investigation and remediation planning. At this time, we cannot estimate future remediation costs associated with these sites beyond those described below.

#### Manufactured Gas Plant Sites:

We have identified several sites at which Wisconsin Electric, Wisconsin Gas, or a predecessor company historically owned or operated a manufactured gas plant. These sites have been substantially remediated or are at various stages of investigation, monitoring and remediation. We have also identified other sites

that may have been impacted by historical manufactured gas plant activities. Based upon ongoing analysis, we estimate that the future costs for detailed site investigation and future remediation costs may range from \$35 to \$65 million over the next ten years. This estimate is dependent upon several variables including, among other things, the extent of remediation, changes in technology and changes in regulation. As of December 31, 2009, we have

established reserves of \$52.2 million related to future remediation costs.

The PSCW has allowed Wisconsin utilities, including Wisconsin Electric and Wisconsin Gas, to defer the costs spent on the remediation of manufactured gas plant sites, and has allowed for these costs to be recovered in rates over five years. Accordingly, we have recorded a regulatory asset for remediation costs.

#### Ash Landfill Sites:

Wisconsin Electric aggressively seeks environmentally acceptable, beneficial uses for its coal combustion by-products. However, some coal-ash by-products have been, and to a small degree continue to be, managed in company-owned, licensed landfills. Some early designed and constructed landfills have at times required various levels of monitoring or remediation. Where Wisconsin Electric has become aware of these conditions, efforts have been made to define the nature and extent of any release, and work has been performed to address these conditions. The costs of these efforts are recovered under the fuel clause for Wisconsin Electric and are expensed as incurred. During 2009, 2008 and 2007, Wisconsin Electric incurred \$0.3 million, \$1.3 million and \$0.8 million respectively, in coal-ash remediation expenses. As of December 31, 2009, we have no reserves established related to ash landfill sites.

#### EPA - Consent Decree:

In April 2003, Wisconsin Electric reached a Consent Decree with the EPA, in which it agreed to significantly reduce air emissions from its coal-fired generating facilities. In July 2003, the Consent Decree was amended to include the state of Michigan, and in October 2007, the U.S. District Court for the Eastern District of Wisconsin approved and entered the amended Consent Decree. The reductions are expected to be achieved by 2013 through a combination of installing new pollution control equipment, upgrading existing equipment and retiring certain older units. Through December 31, 2009, we have spent approximately \$686 million associated with the installation of air quality controls and have retired four coal units as part of our plan under the Consent Decree. The total cost of implementing this agreement is estimated to be \$1.2 billion over the 10 year period ending 2013.

#### Oak Creek:

Bechtel, the contractor of the Oak Creek expansion under a fixed price contract, submitted claims to us for schedule and cost relief on December 22, 2008 related to the delay of the in-service dates for OC 1 and OC 2. These claims were asserted against ERS, the project manager for the construction of the Oak Creek expansion and agent for the joint owners of OC 1 and OC 2. On October 30, 2009, Bechtel amended its claim to increase its request for cost relief and schedule relief. In its amended claim, Bechtel requested cost relief totaling approximately \$517.5 million and schedule relief that would have resulted in approximately seven months of relief from liquidated damages beyond the guaranteed in-service date of September 29, 2009 for OC 1 and approximately four months of relief from liquidated damages beyond the guaranteed in-service date of September 29, 2010 for OC 2.

Bechtel's first claim was based on the alleged impact of severe weather and certain labor-related matters. Pursuant to its amended claim, Bechtel was requesting approximately \$445.5 million in costs related to changed weather and labor conditions. Bechtel's second claim of approximately \$72 million sought cost and schedule relief for the alleged effects of ERS-directed changes and delays allegedly caused by ERS prior to the issuance of the Full Notice to Proceed in July 2005. These claims, as well as claims submitted by ERS related to the rights of the parties under the construction contract and ERS counterclaims, had been submitted to binding arbitration.

Effective December 16, 2009, ERS and Bechtel entered into the Settlement Agreement that settled all claims between them regarding OC 1 and OC 2. Pursuant to the terms of this Settlement Agreement, ERS will pay to Bechtel \$72 million to settle these claims, with \$10 million already paid in 2009 and the remaining \$62 million to be paid in six additional installments upon the achievement of specific project milestones. In addition, Bechtel will receive 120 days of schedule relief for OC 1 and 60 days for OC 2. Therefore, the guaranteed in-service date of September 29, 2009 for OC 1 was extended to January 27, 2010, and the guaranteed in-service date of September 29, 2010 for OC 2 was extended to November 28, 2010.

We are responsible for approximately 85% of amounts paid under the Settlement Agreement, consistent with our ownership share of the Oak Creek expansion. The other joint owners are responsible for the remainder.

The Settlement Agreement also provides for Bechtel's release of ERS from all matters related to Bechtel's claims, among other things, and for ERS' release of Bechtel from all matters related to ERS' claims that were subject to arbitration, among other things.

#### Cash Balance Pension Plan:

On June 30, 2009, a lawsuit was filed by a former employee, against the Plan in the U.S. District Court for the Eastern District of Wisconsin. Counsel representing the plaintiff is attempting to seek class certification for other similarly situated plaintiffs. The complaint alleges that Plan participants who received a lump sum distribution under the Plan prior to their normal retirement age did not receive the full benefit to which they were entitled in violation of ERISA and are owed additional benefits, because the Plan failed to apply the correct interest crediting rate to project the cash balance account to their normal retirement age. We believe the Plan correctly calculated the lump-sum distributions. An adverse outcome of this lawsuit could affect our Plan funding and expense. We are currently unable to predict the final outcome or impact of this litigation.

#### T -- SUPPLEMENTAL CASH FLOW INFORMATION

During the twelve months ended December 31, 2009, we paid \$152.3 million in interest, net of amounts capitalized, and received \$27.9 million in net refunds from income taxes. During the twelve months ended December 31, 2008, we paid \$144.2 million in interest, net of amounts capitalized, and \$2.4 million in income taxes, net of refunds. During the twelve months ended December 31, 2007, we paid \$191.4 million in interest, net of amounts capitalized, and \$291.6 million in income taxes, net of refunds.

As of December 31, 2009, 2008 and 2007, the amount of accounts payable related to capital expenditures was \$14.7 million, \$45.1 million and \$132.6 million, respectively.

#### U -- SUBSEQUENT EVENT

On February 2, 2010, OC 1 was placed into service and is fully operational. Wisconsin Electric now has care, custody and control and will operate and maintain the unit.

On February 11, 2010, we issued a total of \$530 million in long-term debt (\$255 million aggregate principal amount of 5.209% Series A Senior Notes due February 11, 2030 and \$275 million aggregate principal amount of 6.09% Series A Senior Notes due February 11, 2040), and used the net proceeds to repay debt incurred to finance the construction of OC 1.

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#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Wisconsin Energy Corporation:



We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of Wisconsin Energy Corporation and subsidiaries (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of income, common equity, and cash flows for each of the three years in the period ended December 31, 2009. Our audits also included the financial statement schedules listed in the Index at Item 15. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Wisconsin Energy Corporation and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2010 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/DELOITTE & TOUCHE LLP

Milwaukee, Wisconsin  
February 26, 2010

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

### **To the Board of Directors and Stockholders of Wisconsin Energy Corporation:**

We have audited the internal control over financial reporting of Wisconsin Energy Corporation and subsidiaries (the "Company") as of December 31, 2009, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is

responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedules as of and for the year ended December 31, 2009 of the Company and our report dated February 26, 2010 expressed an unqualified opinion on those financial statements and financial statement schedules.

/s/DELOITTE & TOUCHE LLP

Milwaukee, Wisconsin  
February 26, 2010

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective (i) in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and (ii) to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of Wisconsin Energy Corporation's and subsidiaries internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its evaluation, our management concluded that Wisconsin Energy Corporation's and subsidiaries internal control over financial reporting was effective as of December 31, 2009.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Deloitte & Touche LLP, an independent registered public accounting firm, as auditors of our financial statements has issued an attestation report on the effectiveness of Wisconsin Energy Corporation's and its subsidiaries' internal

control over financial reporting as of December 31, 2009. Deloitte & Touche LLP's report is included in this report.

#### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fourth quarter of 2009 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### ITEM 9B. OTHER INFORMATION

None.

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### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE OF THE REGISTRANT

The information under "Proposal 1: Election of Directors - Terms Expiring in 2011", "Section 16(a) Beneficial Ownership Reporting Compliance", "Corporate Governance - Frequently Asked Questions: What is the process used to identify director nominees and how do I recommend a nominee to the Corporate Governance Committee?", "Corporate Governance - Frequently Asked Questions: Are the Audit and Oversight, Corporate Governance and Compensation Committees comprised solely of independent directors?", "Corporate Governance - Frequently Asked Questions: Are all the members of the Audit Committee financially literate and does the committee have an audit committee financial expert?" and "Committees of the Board of Directors - Audit and Oversight" in our definitive Proxy Statement on Schedule 14A to be filed with the SEC for our Annual Meeting of Stockholders to be held May 6, 2010 (the "2010 Annual Meeting Proxy Statement") is incorporated herein by reference. Also see "Executive Officers of the Registrant" in Part I of this report.

We have adopted a written code of ethics, referred to as our Code of Business Conduct, that all of our directors, executive officers and employees, including the principal executive officer, principal financial officer and principal accounting officer, must comply with. We have posted our Code of Business Conduct on our website, [www.wisconsinenergy.com](http://www.wisconsinenergy.com). We have not provided any waiver to the Code for any director, executive officer or other employee. Any amendments to, or waivers for directors and executive officers from, the Code of Business Conduct will be disclosed on our website or in a current report on Form 8-K.

Our website, [www.wisconsinenergy.com](http://www.wisconsinenergy.com), also contains our Corporate Governance Guidelines and the charters of our Audit and Oversight, Corporate Governance and Compensation Committees.

Our Code of Business Conduct, Corporate Governance Guidelines and committee charters are also available without charge to any stockholder of record or beneficial owner of our common stock by writing to the corporate secretary, Susan H. Martin, at our principal business office, 231 West Michigan Street, P.O. Box 1331, Milwaukee, Wisconsin 53201.

## ITEM 11. EXECUTIVE COMPENSATION

The information under "Compensation Discussion and Analysis", "Executive Officers' Compensation", "Director Compensation", "Committees of the Board of Directors - Compensation", "Compensation Committee Report", "Risk Analysis of WEC's Compensation Policies and Practices" and "Certain Relationships and Related Transactions - Compensation Committee Interlocks and Insider Participation" in the 2010 Annual Meeting Proxy Statement is incorporated herein by reference.

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## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The security ownership information called for by Item 12 of Form 10-K is incorporated herein by reference to this information included under "WEC Common Stock Ownership" in the 2010 Annual Meeting Proxy Statement.

## EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information about our equity compensation plans as of December 31, 2009:

| Plan Category  | (a)<br>Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b)<br>Weighted-average exercise price of outstanding options, warrants and rights | (c)<br>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|--|--|--|--|
| Equity compensation plans approved by security holders | 9,082,934 (1)  | \$38.50  | 1,237,622  |
| Equity compensation plans not approved                 | -  | -  | -  |

by security  
holders

|           |           |         |           |
|-----------|-----------|---------|-----------|
| Total (2) | 9,082,934 | \$38.50 | 1,237,622 |
|-----------|-----------|---------|-----------|

- (1) Represents options to purchase our common stock granted under our 1993 Omnibus Stock Incentive Plan, as amended.
- (2) Also outstanding were options to purchase 4,381 shares of our common stock at a weighted average exercise price of \$19.62 per share granted under the stock option plans of WICOR and assumed in connection with the acquisition of WICOR in April 2000. No further awards were or will be made under the WICOR stock option plans.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information under "Corporate Governance - Frequently Asked Questions: Who are the independent directors?", "Corporate Governance - Frequently Asked Questions: What are the Board's standards of independence" and "Certain Relationships and Related Transactions" in the 2010 Annual Meeting Proxy Statement is incorporated herein by reference. A full description of the guidelines our Board uses to determine director independence is located in Appendix A of our Corporate Governance Guidelines, which can be found on our website, [www.wisconsinenergy.com](http://www.wisconsinenergy.com).

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information regarding the fees paid to, and services performed by, our independent auditors and the pre-approval policy of our audit and oversight committee under "Independent Auditors' Fees and Services" in the 2010 Annual Meeting Proxy Statement is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

- (a) 1. FINANCIAL STATEMENTS AND REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM INCLUDED IN PART II OF THIS REPORT

Consolidated Income Statements for the three years ended December 31, 2009.

Consolidated Balance Sheets at December 31, 2009 and 2008.

Consolidated Statements of Cash Flows for the three years ended December 31, 2009.

Consolidated Statements of Common Equity for the three years ended December 31, 2009.

Consolidated Statements of Capitalization at December 31, 2009 and 2008.

Notes to Consolidated Financial Statements.

Reports of Independent Registered Public Accounting Firm.

## 2. FINANCIAL STATEMENT SCHEDULES INCLUDED IN PART IV OF THIS REPORT

Schedule I Condensed Parent Company Financial Statements, including Income Statements and Cash Flows for the three years ended December 31, 2009 and Balance Sheets at December 31, 2009 and 2008.

Schedule II, Valuation and Qualifying Accounts, for the three years ended December 31, 2009.

Other schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the financial statements or notes thereto.

## 3. EXHIBITS AND EXHIBIT INDEX

See the Exhibit Index included as the last part of this report, which is incorporated herein by reference. Each management contract and compensatory plan or arrangement required to be filed as an exhibit to this report is identified in the Exhibit Index by two asterisks (\*\*) following the description of the exhibit.

### WISCONSIN ENERGY CORPORATION

#### INCOME STATEMENTS

(Parent Company Only)

#### SCHEDULE I -- CONDENSED PARENT COMPANY FINANCIAL STATEMENTS

Year Ended December 31

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|  | <u>2009</u>           | <u>2008</u>    | <u>2007</u>    |
|--|-----------------------|----------------|----------------|
|  | (Millions of Dollars) |                |                |
| Other Income, Net  | \$24.2                | \$31.8         | \$23.4         |
| Corporate Expense  | 8.9                   | 3.4            | 3.3            |
| Interest Expense   | 50.2                  | 68.8           | 70.3           |
| Loss before Taxes  | <u>(34.9)</u>         | <u>(40.4)</u>  | <u>(50.2)</u>  |
| Income Tax Benefit   | <u>14.7</u>           | <u>17.7</u>    | <u>20.9</u>    |
| Loss after Taxes   | (20.2)                | (22.7)         | (29.3)         |
| Equity in Subsidiaries' Continuing Operations  | 397.4                 | 380.5          | 365.0          |
| Income from Continuing Operations  | <u>377.2</u>          | <u>357.8</u>   | <u>335.7</u>   |
| Income (Loss) from Discontinued Operations including Equity in Subsidiaries' Discontinued Operations | <u>5.2</u>            | <u>1.3</u>     | <u>(0.1)</u>   |
| Net Income   | <u>\$382.4</u>        | <u>\$359.1</u> | <u>\$335.6</u> |

See accompanying notes to condensed parent company financial statements.

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WISCONSIN ENERGY CORPORATION

STATEMENTS OF CASH FLOWS

(Parent Company Only)

SCHEDULE I - CONDENSED PARENT COMPANY  
FINANCIAL STATEMENTS - (Cont'd)

| Year Ended December 31 |             |             |
|------------------------|-------------|-------------|
| <u>2009</u>            | <u>2008</u> | <u>2007</u> |
| (Millions of Dollars)  |             |             |



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|  |         |         |         |
|--|---------|---------|---------|
| Operating Activities                             |         |         |         |
| Net income                                       | \$382.4 | \$359.1 | \$335.6 |
| Reconciliation to cash                           |         |         |         |
| Equity in subsidiaries' earnings                 | (397.7) | (381.3) | (365.8) |
| Dividends from subsidiaries                      | 225.2   | 451.0   | 268.7   |
| Deferred income taxes, net                       | 27.3    | 23.2    | 13.1    |
| Accrued income taxes, net                        | (11.8)  | (57.6)  | 35.6    |
| Change in - Other current assets                 | 0.1     | (0.1)   | 0.1     |
| Change in - Other current liabilities            | (0.4)   | (0.3)   | 5.5     |
| Change in - Accounts receivable                  | 1.7     | (46.5)  | (245.9) |
| Other  | 11.8    | (6.4)   | (9.4)   |
| Cash Provided by Operating Activities            | 238.6   | 341.1   | 37.5    |
| Investing Activities                             |         |         |         |
| Capital contributions to associated companies    | (108.9) | (140.0) | (273.7) |
| Capitalized interest and other                   | (42.7)  | (41.9)  | (39.9)  |
| Cash Used In Investing Activities                | (151.6) | (181.9) | (313.6) |
| Financing Activities                             |         |         |         |
| Exercise of stock options                        | 17.0    | 11.6    | 36.1    |
| Purchase of common stock                         | (29.6)  | (23.0)  | (67.8)  |
| Dividends paid on common stock                   | (157.8) | (126.3) | (116.9) |
| Issuance of long-term debt                       | 11.4    | 257.5   | 493.0   |
| Retirement of long-term debt                     | -       | (300.0) | -       |
| Change in short-term debt                        | 74.0    | 11.7    | (86.3)  |
| Change in notes payable due associated companies | (6.6)   | 5.5     | 11.8    |
| Other  | 3.4     | 2.7     | 8.2     |
| Cash Provided by (Used In) Financing Activities  | (88.2)  | (160.3) | 278.1   |
| Change in Cash and Cash Equivalents              | (1.2)   | (1.1)   | 2.0     |
| Cash and Cash Equivalents                        |         |         |         |
| at Beginning of Year                             | 1.9     | 3.0     | 1.0     |
| Cash and Cash Equivalents                        |         |         |         |
| at End of Year                                   | \$0.7   | \$1.9   | \$3.0   |

See accompanying notes to condensed parent company financial statements.

## WISCONSIN ENERGY CORPORATION

## BALANCE SHEETS

(Parent Company Only)

SCHEDULE I - CONDENSED PARENT COMPANY  
FINANCIAL STATEMENTS - (Cont'd)

|  | December 31           |            |
|--|-----------------------|------------|
|  | 2009                  | 2008       |
|  | (Millions of Dollars) |            |
| Assets   |                       |            |
| Current Assets   |                       |            |
| Cash and cash equivalents                                  | \$ 0.7                | \$ 1.9     |
| Accounts and notes receivable<br>from associated companies | 516.1                 | 517.9      |
| Prepaid taxes and other                                    | 132.8                 | 126.6      |
| Total Current Assets                                       | 649.6                 | 646.4      |
| Property and Investments                                   |                       |            |
| Investment in subsidiary companies                         | 4,919.6               | 4,624.2    |
| Other  | 130.8                 | 89.5       |
| Total Property and Investments                             | 5,050.4               | 4,713.7    |
| Deferred Charges and Other Assets                          | 93.2                  | 88.1       |
| Total Assets   | \$ 5,793.2            | \$ 5,448.2 |
| Liabilities and Equity                                     |                       |            |
| Current Liabilities  |                       |            |
| Long-term debt due currently                               | \$ 281.5              | \$ -       |
| Short-term debt  | 573.4                 | 499.4      |
| Notes payable due associated companies                     | 26.9                  | 33.5       |
| Other  | 31.1                  | 32.0       |
| Total Current Liabilities                                  | 912.9                 | 564.9      |
| Long-term debt   | 1,141.7               | 1,410.7    |
| Other Long-term liabilities                                | 171.7                 | 135.7      |
| Stockholder's equity                                       | 3,566.9               | 3,336.9    |

|                              |                   |                   |
|------------------------------|-------------------|-------------------|
| Total Liabilities and Equity | <u>\$ 5,793.2</u> | <u>\$ 5,448.2</u> |
|------------------------------|-------------------|-------------------|

See accompanying notes to condensed parent company financial statements.

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WISCONSIN ENERGY CORPORATION

NOTES TO FINANCIAL STATEMENTS

(Parent Company Only)

SCHEDULE I - CONDENSED PARENT COMPANY  
FINANCIAL STATEMENTS - (Cont'd)

1. For Parent Company only presentation, investment in subsidiaries are accounted for using the equity method. The condensed Parent Company financial statements and notes should be read in conjunction with the consolidated financial statements and notes of Wisconsin Energy Corporation appearing in this Annual Report on Form 10-K.

2. Wisconsin Energy's ability as a holding company to pay common dividends primarily depends on the availability of funds received from the Parent Company's principal utility subsidiaries, Wisconsin Electric and Wisconsin Gas. During 2009, Wisconsin Electric and Wisconsin Gas collectively provided Wisconsin Energy with \$212.6 million of dividends and distributions. In the future, as construction of the new PTF plants is completed and the plants are placed in service, it is expected that We Power will also be a source for distributions to Wisconsin Energy.

Various financing arrangements and regulatory requirements impose certain restrictions on the ability of the Parent Company's subsidiaries to transfer funds to the Parent Company in the form of cash dividends or advances. In addition, under Wisconsin law, Wisconsin Electric and Wisconsin Gas are prohibited from loaning funds, either directly or indirectly, to the Parent Company.

Wisconsin Energy does not believe that these restrictions will materially affect the Parent Company's operations or limit any dividend payments in the foreseeable future.

3. As of December 31, 2009, the maturities of the Parent Company long-term debt outstanding were as follows:

|            | <u>(Millions<br/>of Dollars)</u> |
|------------|----------------------------------|
| 2010       | \$ 281.5                         |
| 2011       | 450.0                            |
| 2012       | -                                |
| 2013       | -                                |
| 2014       | -                                |
| Thereafter | <u>700.0</u>                     |

Total \$1,431.5

Wisconsin Energy amortizes debt premiums, discounts and debt issuance costs over the lives of the debt and includes the costs in interest expense.

During 2009, Wisconsin Energy issued \$11.4 million of new notes and used the proceeds to repay short-term debt.

In December 2008, Wisconsin Energy borrowed \$260 million under an 18-month credit agreement and used such amount to repay short-term debt. Similar to Wisconsin Energy's bank back-up credit facility, this agreement requires Wisconsin Energy to maintain, subject to certain exclusions, a minimum funded debt to capitalization ratio of less than 70%, and also contains customary covenants, including certain limitations on our ability to sell assets. The credit agreement also contains customary events of default. In addition, Wisconsin Energy must ensure that certain of its subsidiaries comply with many of the covenants contained therein. As of December 31, 2009, Wisconsin Energy was in compliance with all covenants under the credit agreement.

During 2008, Wisconsin Energy retired \$300 million of notes through the issuance of short-term debt.

In May 2007, Wisconsin Energy issued \$500 million of Junior Notes. Due to certain features of the Junior Notes, rating agencies consider them to be hybrid instruments with a combination of debt and equity characteristics. These securities were issued under a shelf registration statement filed with the SEC in May 2007 for an unlimited number

of debt securities, which became effective upon filing. The Junior Notes bear interest at 6.25% per year until May 15, 2017. Beginning May 15, 2017, the Junior Notes bear interest at the three-month London Interbank Offered Rate (LIBOR) plus 2.1125%, reset quarterly. The proceeds from this issuance were used to repay short-term debt incurred to both fund PTF and for other working capital purposes.

In connection with the issuance of the Junior Notes, Wisconsin Energy executed the RCC for the benefit of persons that buy, hold or sell a specified series of long-term indebtedness (covered debt). Wisconsin Energy's 6.20% Senior Notes due April 1, 2033 have been initially designated as the covered debt under the RCC. The RCC provides that Wisconsin Energy may not redeem, defease or purchase and our subsidiaries may not purchase any Junior Notes on or before May 15, 2037, unless, subject to certain limitations described in the RCC, during the 180 days prior to the date of redemption, defeasance or purchase, we have received a specified amount of proceeds from the sale of qualifying securities.

Wisconsin Energy has entered into a bank back-up credit facility to maintain short-term liquidity which, among other terms, requires Wisconsin Energy to maintain, subject to certain exclusions, a minimum total funded debt to capitalization ratio of less than 70%.

Wisconsin Energy's bank back-up credit facility contains customary covenants, including certain limitations on its ability to sell assets. The credit facility also contains customary events of default, including payment defaults, material inaccuracy of representations and warranties, covenant defaults, bankruptcy proceedings, certain judgments, ERISA defaults and change of control. In addition, pursuant to the terms of the credit facility, Wisconsin Energy must ensure that certain of its subsidiaries comply with many of the covenants contained therein.

As of December 31, 2009, Wisconsin Energy was in compliance with all covenants.

4. Wisconsin Energy and certain of its subsidiaries enter into various guarantees to provide financial and performance assurance to third parties on behalf of affiliates. As of December 31, 2009, Wisconsin Energy had the following guarantees:

|                    | Maximum<br>Potential<br>Future<br>Payments | Outstanding<br>as of Dec.31,<br>2009 | Liability<br>Recorded as<br>of<br>Dec. 31, 2009 |
|--------------------|--|--------------------------------------|---|
|                    | <u>                    </u>                | <u>                    </u>          | <u>                    </u>                     |
|                    | (Millions of Dollars)                      |                                      |   |
| Wisconsin Energy   |  |                                      |   |
| Guarantees         |  |                                      |   |
| Utility            | \$8.9                                      | \$8.9                                | \$ -  |
| Non-Utility Energy | 123.0                                      | 28.6                                 | -   |
| Other              | 0.4  | 0.2                                  | -   |
|                    | <u>                    </u>                | <u>                    </u>          | <u>                    </u>                     |
| Total              | \$132.3                                    | \$37.7                               | \$ -  |
| Letters of Credit  | \$1.1                                      | \$0.2                                | \$ -  |

Utility guarantees support obligations of the utility segment under surety bonds, worker's compensation and interconnection agreements.

Wisconsin Energy's guarantees in support of its non-utility energy segment guaranty performance and payment obligations of We Power and Wisvest. The guarantees which support We Power are for obligations under purchase, construction and lease agreements with the utility segment and third parties.

A guarantee in support of Wisvest-Connecticut which we sold in December 2002 to PSEG provides financial assurance for potential obligations relating to environmental remediation under the original purchase agreement with The United Illuminating Company. The potential obligations for environmental remediation, which are unlimited, are reimbursable by PSEG under the terms of the sale agreement in the event that Wisconsin Energy is required to perform under the guarantee. Guarantees also support obligations to third parties under the agreement with PSEG for the sale of Wisvest-Connecticut and post-closing obligations including indemnity obligations related to environmental condition and other matters under the Calumet facility sale agreement which was effective May 31, 2005.

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Wisconsin Energy's maximum aggregate exposure under the indemnification provisions of the Calumet facility sale agreement, except for retention of the full exposure to indemnify for environmental claims related to certain property no longer leased or owned by Wisconsin Energy or its subsidiaries, is \$35 million.

Wisconsin Energy has a guarantee that supports an environmental indemnification obligation, which is unlimited, associated with the Minergy Neenah plant and indemnifications related to the post-closing obligations under the Minergy Neenah sale agreement which was effective September 7, 2006. Wisconsin Energy's other guarantees also support obligations to third parties under purchase and loan agreements and surety bonds. In the event the guarantee

fails to perform, Wisconsin Energy would be responsible for the obligations.

5. During the twelve months ended December 31, 2009, Wisconsin Energy paid \$45.2 million in interest, net of amounts capitalized, and received \$36.0 million in refunds from income taxes. During the twelve months ended December 31, 2008, Wisconsin Energy paid \$65.6 million in interest, net of amounts capitalized, and received \$1.3 million in refunds from income taxes. During the twelve months ended December 31, 2007, Wisconsin Energy paid \$63.5 million in interest, net of amounts capitalized, and \$70.5 million in income taxes, net of refunds.

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## SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

| Allowance for Doubtful<br>Accounts | Balance at<br>Beginning<br>of the<br>Period | Expense | Deferral | Net<br>Write-offs | Balance at<br>End of the<br>Period |
|------------------------------------|---|---------|----------|-------------------|------------------------------------|
| (Millions of Dollars)              |   |         |          |                   |                                    |
| December 31, 2009                  | \$48.8                                      | \$54.6  | \$12.9   | (\$58.4)          | \$57.9                             |
| December 31, 2008                  | \$38.0                                      | \$54.2  | \$8.1    | (\$51.5)          | \$48.8                             |
| December 31, 2007                  | \$35.1                                      | \$38.2  | \$8.9    | (\$44.2)          | \$38.0                             |

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WISCONSIN ENERGY CORPORATION

By /s/GALE E. KLAPPA

Date:

Gale E. Klappa, Chairman of the Board, President

February 26, 2010

and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/GALE E. KLAPPA February 26, 2010

Gale E. Klappa, Chairman of the Board, President and Chief Executive Officer and Director -- Principal Executive Officer

/s/ALLEN L. LEVERETT February 26, 2010

Allen L. Leverett, Executive Vice President and Chief Financial Officer -- Principal Financial Officer

/s/STEPHEN P. DICKSON February 26, 2010

Stephen P. Dickson, Vice President and Controller -- Principal Accounting Officer

/s/JOHN F. BERGSTROM February 26, 2010

John F. Bergstrom, Director

/s/BARBARA L. BOWLES February 26, 2010

Barbara L. Bowles, Director

/s/PATRICIA W. CHADWICK February 26, 2010

Patricia W. Chadwick, Director

/s/ROBERT A. CORNOG February 26, 2010

Robert A. Cornog, Director

/s/CURT S. CULVER February 26, 2010

Curt S. Culver, Director

/s/THOMAS J. FISCHER February 26, 2010

Thomas J. Fischer, Director

/s/ULICE PAYNE, JR. February 26, 2010

Ulice Payne, Jr., Director

/s/FREDERICK P. STRATTON, JR. February 26, 2010

Frederick P. Stratton, Jr., Director

WISCONSIN ENERGY CORPORATION  
(Commission File No. 001-09057)

EXHIBIT INDEX  
to  
Annual Report on Form 10-K  
For the year ended December 31, 2009

The following exhibits are filed or furnished with or incorporated by reference in the report with respect to Wisconsin Energy Corporation. (An asterisk (\*) indicates incorporation by reference pursuant to Exchange Act Rule 12b-32.)

| <u>Number</u> | <u>Exhibit</u>  |
|---------------|---|
| 3             | Articles of Incorporation and By-laws   |
| 3.1*          | Restated Articles of Incorporation of Wisconsin Energy Corporation, as amended and restated effective June 12, 1995. (Exhibit (3)-1 to Wisconsin Energy Corporation's 06/30/95 Form 10-Q.)                      |
| 3.2*          | Bylaws of Wisconsin Energy Corporation, as amended to May 5, 2005. (Exhibit 3.2(b) to Wisconsin Energy Corporation's 12/31/04 Form 10-K.)   |
| 4             | Instruments defining the rights of security holders, including indentures   |
| 4.1*          | Reference is made to Article III of the Restated Articles of Incorporation and the Bylaws of Wisconsin Energy Corporation. (Exhibits 3.1 and 3.2 herein.)   |
| 4.2*          | Replacement Capital Covenant, dated May 11, 2007, by Wisconsin Energy Corporation for the benefit of certain debtholders named therein. (Exhibit 4.2 to Wisconsin Energy Corporation's 05/08/07 Form 8-K.)      |
|               | Indentures and Securities Resolutions:  |
| 4.3*          | Indenture for Debt Securities of Wisconsin Electric Power Company (the "Wisconsin Electric Indenture"), dated December 1, 1995. (Exhibit (4)-1 under File No. 1-1245, Wisconsin Electric's 12/31/95 Form 10-K.) |
| 4.4*          | Securities Resolution No. 1 of Wisconsin Electric under the Wisconsin Electric Indenture, dated December 5, 1995. (Exhibit (4)-2 under File No. 1-1245, Wisconsin Electric's 12/31/95 Form 10-K.)               |



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- 4.5\* Securities Resolution No. 2 of Wisconsin Electric under the Wisconsin Electric Indenture, dated November 12, 1996. (Exhibit 4.44 to Wisconsin Energy Corporation's 12/31/96 Form 10-K.)
- 4.6\* Securities Resolution No. 3 of Wisconsin Electric under the Wisconsin Electric Indenture, dated May 27, 1998. (Exhibit (4)-1 under File No. 1-1245, Wisconsin Electric's 06/30/98 Form 10-Q.)
- 4.7\* Securities Resolution No. 4 of Wisconsin Electric under the Wisconsin Electric Indenture, dated November 30, 1999. (Exhibit 4.46 under File No. 1-1245, Wisconsin Energy Corporation's/Wisconsin Electric's 12/31/99 Form 10-K.)

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| <u>Number</u> | <u>Exhibit</u>   |
|---------------|--|
| 4.8*          | Securities Resolution No. 5 of Wisconsin Electric under the Wisconsin Electric Indenture, dated as of May 1, 2003. (Exhibit 4.47 filed with Post-Effective Amendment No. 1 to Wisconsin Electric's Registration Statement on Form S-3 (File No. 333-101054), filed May 6, 2003.)             |
| 4.9*          | Securities Resolution No. 6 of Wisconsin Electric under the Wisconsin Electric Indenture, dated as of November 17, 2004. (Exhibit 4.48 filed with Post-Effective Amendment No. 1 to Wisconsin Electric's Registration Statement on Form S-3 (File No. 333-113414), filed November 23, 2004.) |
| 4.10*         | Securities Resolution No. 7 of Wisconsin Electric under the Wisconsin Electric Indenture, dated as of November 2, 2006. (Exhibit 4.1 to Wisconsin Electric's 11/02/06 Form 8-K.)   |
| 4.11*         | Securities Resolution No. 8 of Wisconsin Electric under the Wisconsin Electric Indenture, dated as of September 25, 2008. (Exhibit 4.1 to Wisconsin Electric's 09/25/08 Form 8-K.)   |
| 4.12*         | Securities Resolution No. 9 of Wisconsin Electric under the Wisconsin Electric Indenture, dated as of December 8, 2008. (Exhibit 4.1 to Wisconsin Electric's 12/08/08 Form 8-K.)   |

- 4.13\* Securities Resolution No. 10 of Wisconsin Electric under the Wisconsin Electric Indenture, dated as of December 8, 2009. (Exhibit 4.1 to Wisconsin Electric's 12/08/09 Form 8-K.)
- 4.14\* Indenture for Debt Securities of Wisconsin Energy Corporation (the "Wisconsin Energy Indenture"), dated as of March 15, 1999. (Exhibit 4.46 to Wisconsin Energy Corporation's 03/25/99 Form 8-K.)
- 4.15\* Securities Resolution No. 1 of Wisconsin Energy under the Wisconsin Energy Indenture, dated as of March 16, 1999. (Exhibit 4.47 to Wisconsin Energy Corporation's 03/25/99 Form 8-K.)
- 4.16\* Securities Resolution No. 2 of Wisconsin Energy under the Wisconsin Energy Indenture, dated as of March 23, 2001. (Exhibit 4.1 to Wisconsin Energy Corporation's 03/31/01 Form 10-Q.)
- 4.17\* Securities Resolution No. 3 of Wisconsin Energy under the Wisconsin Energy Indenture, dated as of November 13, 2001. (Exhibit 4.52 to Wisconsin Energy Corporation's 12/31/01 Form 10-K.)
- 4.18\* Securities Resolution No. 4 of Wisconsin Energy under the Wisconsin Energy Indenture, dated as of March 17, 2003. (Exhibit 4.12 filed with Post-Effective Amendment No. 1 to Wisconsin Energy Corporation's Registration Statement on Form S-3 (File No. 333-69592), filed March 20, 2003.)
- 4.19\* Securities Resolution No. 5 of Wisconsin Energy under the Wisconsin Energy Indenture, dated as of May 8, 2007. (Exhibit 4.1 to Wisconsin Energy Corporation's 05/08/07 Form 8-K.)

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Number

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Exhibit

Certain agreements and instruments with respect to unregistered long-term debt not exceeding 10 percent of the total assets of the Registrant and its subsidiaries on a consolidated basis have been omitted as permitted by related instructions. The Registrant agrees pursuant to Item 601(b)(4) of Regulation S-K to furnish to the Securities and Exchange Commission, upon request, a copy of all such agreements and instruments.

10 Material Contracts

- 10.1\* Asset Sale Agreement by and among Wisconsin Electric Power Company, FPL Energy Point Beach, LLC, as Buyer, and FPL Group Capital Inc., as Buyer's Parent, dated December 19, 2006 (the "Asset Sale Agreement"). (Exhibit 2.1 to Wisconsin Energy Corporation's 12/31/06 Form 10-K.)
- 10.2\* Letter Agreement between Wisconsin Electric Power Company and FPL Energy Point Beach, LLC, dated May 24, 2007, which effectively amends the Asset Sale Agreement. (Exhibit 2.1 to Wisconsin Energy Corporation's 06/30/07 Form 10-Q.)
- 10.3\* Letter Agreement between Wisconsin Electric Power Company, FPL Energy Point Beach, LLC and FPL Group Capital, Inc., dated September 28, 2007, which amends the Asset Sale Agreement. (Exhibit 2.3 to Wisconsin Energy Corporation's 09/28/07 Form 8-K).
- 10.4\* Stock Purchase Agreement among Pentair, Inc., WICOR, Inc. and Wisconsin Energy Corporation, dated February 3, 2004 ("Stock Purchase Agreement"). (Exhibit 2.1 to Wisconsin Energy Corporation's 06/30/04 Form 10-Q.)
- 10.5\* Amendment to the Stock Purchase Agreement dated July 28, 2004. (Exhibit 2.2 to Wisconsin Energy Corporation's 06/30/04 Form 10-Q.)
- 10.6\* Credit Agreement, dated as of April 6, 2006, among Wisconsin Energy Corporation, as Borrower, the Lenders identified therein, and JPMorgan Chase Bank, N.A., as Administrative Agent and Fronting Bank. (Exhibit 10.1 to Wisconsin Energy Corporation's 06/30/09 Form 10-Q.)
- 10.7\* Credit Agreement, dated as of March 30, 2006, among Wisconsin Electric Power Company, as Borrower, the Lenders identified therein, and U.S. Bank National Association, as Administrative Agent and Fronting Bank. (Exhibit 10.2 to Wisconsin Energy Corporation's 06/30/09 Form 10-Q.)
- 10.8\* Credit Agreement, dated as of March 30, 2006, among Wisconsin Gas LLC, as Borrower, the Lenders identified therein, Citibank, N.A., as Administrative Agent, and U.S. Bank National Association, as Fronting Bank.

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(Exhibit 10.3 to Wisconsin Energy Corporation's 03/31/06 Form 10-Q.)

10.9\* Wisconsin Energy Corporation Supplemental Pension Plan, effective as of January 1, 2005. (Exhibit 10.9 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.

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| <u>Number</u> | <u>Exhibit</u>   |
|---------------|--|
| 10.10*        | Service Agreement, dated April 25, 2000, between Wisconsin Electric Power Company and Wisconsin Gas Company (n/k/a Wisconsin Gas LLC). (Exhibit 10.32 to Wisconsin Energy Corporation's 12/31/00 Form 10-K.)   |
| 10.11*        | Executive Deferred Compensation Plan of Wisconsin Energy Corporation, as amended and restated as of July 23, 2004 (including amendments approved effective as of November 2, 2005) (the "Legacy EDCP"). (Exhibit 10.2 to Wisconsin Energy Corporation's 09/30/05 Form 10-Q.)** See Note. |
| 10.12*        | First Amendment to the Legacy EDCP, effective as of January 1, 2005. (Exhibit 10.12 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)** See Note.   |
| 10.13*        | Wisconsin Energy Corporation Executive Deferred Compensation Plan, effective as of January 1, 2005. (Exhibit 10.13 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)** See Note.  |
| 10.14*        | Directors' Deferred Compensation Plan of Wisconsin Energy Corporation, as amended and restated as of May 1, 2004 (the "Legacy DDCP"). (Exhibit 10.3 to Wisconsin Energy Corporation's 06/30/04 Form 10-Q.)** See Note.   |
| 10.15*        | First Amendment to the Legacy DDCP, effective as of January 1, 2005. (Exhibit 10.15 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)** See Note.   |
| 10.16*        | Wisconsin Energy Corporation Directors' Deferred Compensation Plan, effective as of January 1, 2005. (Exhibit 10.16 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)** See Note.   |

- 10.17\* Wisconsin Energy Corporation Short-Term Performance Plan, as amended and restated effective as of January 1, 2010. (Exhibit 10.1 to Wisconsin Energy Corporation's 12/03/09 Form 8-K.)\*\* See Note.
- 10.18\* Wisconsin Energy Corporation Amended and Restated Executive Severance Policy, effective as of January 1, 2008. (Exhibit 10.18 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.
- 10.19\* Service Agreement, dated December 29, 2000, between Wisconsin Electric Power Company and American Transmission Company LLC. (Exhibit 10.33 to Wisconsin Energy Corporation's 12/31/00 Form 10-K.)
- 10.20\* Restated Non-Qualified Trust Agreement by and between Wisconsin Energy Corporation and The Northern Trust Company dated February 11, 2004, regarding trust established to provide a source of funds to assist in meeting of the liabilities under various nonqualified deferred compensation plans made between Wisconsin Energy Corporation or its subsidiaries and various plan participants. (Exhibit 10.16 to Wisconsin Energy Corporation's 12/31/07 Form 10-K)\*\* See Note.
- 10.21 Base Salaries of Named Executive Officers of the Registrant.\*\* See Note.
- 10.22\* Employment arrangement with Charles R. Cole, effective August 1, 1999. (Exhibit 10.3 to Wisconsin Energy Corporation's 12/31/00 Form 10-K.)\*\* See Note.
- 10.23\* Amendment of the employment arrangement with Charles R. Cole, dated December 11, 2008. (Exhibit 10.23 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.

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| <u>Number</u> | <u>Exhibit</u>  |
|---------------|---|
| 10.24*        | Affiliated Interest Agreement (Service Agreement), dated December 12, 2002, by and among Wisconsin Energy Corporation and its affiliates. (Exhibit 10.14 to Wisconsin Energy Corporation's 12/31/02 Form 10-K.) |
| 10.25*        |   |

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- Amended and Restated Senior Officer Employment and Non-Compete Agreement between Wisconsin Energy Corporation and Gale E. Klappa, dated as of December 29, 2008. (Exhibit 10.25 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.
- 10.26\* Amended and Restated Senior Officer Employment and Non-Compete Agreement between Wisconsin Energy Corporation and Allen L. Leverett, dated as of December 30, 2008. (Exhibit 10.26 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.
- 10.27\* Amended and Restated Senior Officer Employment and Non-Compete Agreement between Wisconsin Energy Corporation and Frederick D. Kuester, dated as of December 30, 2008. (Exhibit 10.27 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.
- 10.28\* Letter Agreement by and between Wisconsin Energy Corporation and James C. Fleming, dated as of November 23, 2005, which became effective January 3, 2006. (Exhibit 10.31 to Wisconsin Energy Corporation's 12/31/05 Form 10-K.)\*\* See Note.
- 10.29\* Amendment to the Letter Agreement between Wisconsin Energy Corporation and James C. Fleming, dated December 23, 2008. (Exhibit 10.29 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.
- 10.30\* Amended and Restated Senior Officer, Change in Control, Severance and Non-Compete Agreement between Wisconsin Energy Corporation and Kristine A. Rappé, dated as of December 30, 2008. (Exhibit 10.30 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.
- 10.31\* Supplemental Pension Benefit Agreement between Wisconsin Energy Corporation and Stephen Dickson, effective May 23, 2001. (Exhibit 10.1 to Wisconsin Energy Corporation's 06/30/01 Form 10-Q.)\*\* See Note.
- 10.32\* Amendment to the Supplemental Pension Benefit Agreement between Wisconsin Energy Corporation and Stephen Dickson, dated December 29, 2008. (Exhibit 10.32 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.
- 10.33\*

Amended and Restated Non-Compete and Special Severance Tax Protection Agreement between Wisconsin Energy Corporation and Stephen P. Dickson, effective as of January 1, 2008. (Exhibit 10.33 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)\*\* See Note.

- 10.34 Wisconsin Energy Corporation Death Benefit Only Plan, amended and restated as of December 3, 2009. \*\* See Note.
- 10.35\* Forms of Stock Option Agreements under 1993 Omnibus Stock Incentive Plan. (Exhibit 10.5 to Wisconsin Energy Corporation's 12/31/95 Form 10-K. Updated as Exhibit 10.1(a) and 10.1(b) to Wisconsin Energy Corporation's 03/31/00 Form 10-Q.)\*\* See Note.

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| <u>Number</u> | <u>Exhibit</u>   |
|---------------|--|
| 10.36*        | 1998 Revised forms of award agreements under 1993 Omnibus Stock Incentive Plan for non-qualified stock option awards to non-employee directors, restricted stock awards and option awards. (Exhibit 10.11 to Wisconsin Energy Corporation's 12/31/98 Form 10-K.)** See Note. |
| 10.37*        | 2001 Revised forms of award agreements under 1993 Omnibus Stock Incentive Plan for restricted stock awards, incentive stock option awards and non-qualified stock option awards. (Exhibit 10.3 to Wisconsin Energy Corporation's 03/31/01 Form 10-Q.)** See Note.            |
| 10.38*        | 1993 Omnibus Stock Incentive Plan, as approved by the stockholders at the 2001 annual meeting of stockholders, amended and restated effective as of January 1, 2008. (Exhibit 10.37 to Wisconsin Energy Corporation's 12/31/08 Form 10-K.)** See Note.                       |
| 10.39*        | 2005 Terms and Conditions Governing Non-Qualified Stock Option Award under 1993 Omnibus Stock Incentive Plan. (Exhibit 10.1 to Wisconsin Energy Corporation's 12/28/04 Form 8-K.)** See Note.  |
| 10.40*        |  |

- Terms and Conditions Governing Non-Qualified Stock Option Award under the 1993 Omnibus Stock Incentive Plan. (Exhibit 10.1 to Wisconsin Energy Corporation's 09/30/07 Form 10-Q.)\*\* See Note.
- 10.41\* Terms and Conditions Governing Restricted Stock Awards under the 1993 Omnibus Stock Incentive Plan, approved December 3, 2009. (Exhibit 10.3 to Wisconsin Energy Corporation's 12/03/09 Form 8-K.)\*\* See Note.
- 10.42\* Wisconsin Energy Corporation Performance Unit Plan, amended and restated effective as of January 1, 2010. (Exhibit 10.2 to Wisconsin Energy Corporation's 12/03/09 Form 8-K.)\*\* See Note.
- 10.43\* Form of Award of Performance Units under the Wisconsin Energy Corporation Performance Unit Plan. (Exhibit 10.2 to Wisconsin Energy Corporation's 12/06/04 Form 8-K.)\*\* See Note.
- 10.44\* Port Washington I Facility Lease Agreement between Port Washington Generating Station, LLC, as Lessor, and Wisconsin Electric Power Company, as Lessee, dated as of May 28, 2003. (Exhibit 10.7 to Wisconsin Electric Power Company's 06/30/03 Form 10-Q (File No. 001-01245).)
- 10.45\* Port Washington II Facility Lease Agreement between Port Washington Generating Station, LLC, as Lessor, and Wisconsin Electric Power Company, as Lessee, dated as of May 28, 2003. (Exhibit 10.8 to Wisconsin Electric Power Company's 06/30/03 Form 10-Q (File No. 001-01245).)
- 10.46\* Elm Road I Facility Lease Agreement between Elm Road Generating Station Supercritical, LLC, as Lessor, and Wisconsin Electric Power Company, as Lessee, dated as of November 9, 2004. (Exhibit 10.56 to Wisconsin Energy Corporation's 12/31/04 Form 10-K.)
- 10.47\* Elm Road II Facility Lease Agreement between Elm Road Generating Station Supercritical, LLC, as Lessor, and Wisconsin Electric Power Company, as Lessee, dated as of November 9,



2004. (Exhibit 10.57 to Wisconsin Energy Corporation's 12/31/04 Form 10-K.)

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| <u>Number</u>   | <u>Exhibit</u>   |
|---|--|
| 10.48*  | Point Beach Nuclear Plant Power Purchase Agreement between FPL Energy Point Beach, LLC and Wisconsin Electric Power Company, dated as of December 19, 2006 (the "PPA"). (Exhibit 10.1 to Wisconsin Energy Corporation's 03/31/08 Form 10-Q.) |
| 10.49*  | Letter Agreement between Wisconsin Electric Power Company and FPL Energy Point Beach, LLC dated October 31, 2007, which amends the PPA. (Exhibit 10.45 to Wisconsin Energy Corporation's 12/31/07 Form 10-K.)                                |
| Note: Two asterisks (**) identify management contracts and executive compensation plans or arrangements required to be filed as exhibits pursuant to Item 15(b) of Form 10-K. |  |
| 21  | Subsidiaries of the registrant   |
| 21.1  | Subsidiaries of Wisconsin Energy Corporation.  |
| 23  | Consents of experts and counsel  |
| 23.1  | Deloitte & Touche LLP -- Milwaukee, WI, Consent of Independent Registered Public Accounting Firm.  |
| 31  | Rule 13a-14(a) / 15d-14(a) Certifications  |
| 31.1  | Certification Pursuant to Rule 13a-14(a) or 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2  | Certification Pursuant to Rule 13a-14(a) or 15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32  | Section 1350 Certifications  |
| 32.1  | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley   |

Act of 2002.

32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99 Additional exhibits

99.1\* Turnkey Engineering Procurement and Construction Contract for Supercritical Pulverized Coal Fired Electric Generation Facility between Elm Road Services, LLC and Bechtel Power Corporation, dated April 19, 2004, as amended (the "EPC Contract"). (Exhibit 99.1 to Wisconsin Energy Corporation's 09/30/08 Form 10-Q.)\*\*\*

99.2\* Change Order No. 8 to the EPC Contract. (Exhibit 99.2 to Wisconsin Energy Corporation's 09/30/08 Form 10-Q.)

99.3\* Change Order No. 12A to the EPC Contract. (Exhibit 99.3 to Wisconsin Energy Corporation's 09/30/08 Form 10-Q.)

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| <u>Number</u> | <u>Exhibit</u>   |
|---------------|--|
| 99.4*         | Change Order No. 12b to the EPC Contract. (Exhibit 99.4 to Wisconsin Energy Corporation's 09/30/08 Form 10-Q.) |

\*\*\*Wisconsin Energy has received confidential treatment of certain portions of this document from the SEC.

101 Interactive Data File

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