WISCONSIN ENERGY CORP
Form 10-Q
October 27, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the Quarterly Period Ended **September 30, 2010**

| Commission File Number | Registrant; State of Incorporation Address; and Telephone Number | IRS Employer Identification No. |
|---|---|---|
| 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 |

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 [X] No [ ]

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[X] No[ ]

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

| | |
|---|---|
| Large accelerated filer [X] | Accelerated filer [ ] |
| Non-accelerated filer [ ] (Do not check if a smaller reporting company) | 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 [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date (September 30, 2010):

Common Stock, $.01 Par Value, 116,896,897 shares outstanding.

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WISCONSIN ENERGY CORPORATION

FORM 10-Q REPORT FOR THE QUARTER ENDED SEPTEMBER 30, 2010

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Part II -- Other Information





## 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 Subsidiaries | |
| 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 Subsidiaries and Affiliates | |
| ERGSS | Elm Road Generating Station Supercritical, LLC |
| | |
| Federal and State Regulatory Agencies | |
| DOE | United States Department of Energy |
| EPA | United States Environmental Protection Agency |
| FERC | Federal Energy Regulatory Commission |

| | |
|---|---|
| MPSC | Michigan Public Service Commission |
| PSCW | Public Service Commission of Wisconsin |
| SEC | Securities and Exchange Commission |

Environmental Terms

| | |
|---|---|
| CAIR | Clean Air Interstate Rule |
| $NO_x$ | Nitrogen Oxide |
| $SO_2$ | Sulfur Dioxide |

Other Terms and Abbreviations

| | |
|---|---|
| ARRs | Auction Revenue Rights |
| Compensation Committee | Compensation Committee of the Board of Directors |
| CPCN | Certificate of Public Convenience and Necessity |
| Edison Sault | Edison Sault Electric Company |
| ERISA | Employee Retirement Income Security Act of 1974 |
| Exchange Act | Securities Exchange Act of 1934, as amended |
| Fitch | Fitch Ratings |
| FTRs | Financial Transmission Rights |
| Junior Notes | Wisconsin Energy's 2007 Series A Junior Subordinated Notes due 2067 issued in May 2007 |
| LMP | Locational Marginal Price |
| MISO | Midwest Independent Transmission System Operator, Inc. |
| OTC | Over-the-Counter |
| Plan | The Wisconsin Energy Corporation Retirement Account Plan |
| Point Beach | Point Beach Nuclear Power Plant |
| PTF | Power the Future |
| S&P | Standard & Poor's Ratings Services |



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 Unit(s) |
| Dth | Dekatherm(s) (One Dth equals one million Btu) |
| MW | Megawatt(s) (One MW equals one million Watts) |

| | |
|---|---|
| MWh | Megawatt-hour(s) |
| Watt | A measure of power production or usage |

<u>Accounting Terms</u>

| | |
|---|---|
| AFUDC | Allowance for Funds Used During Construction |
| GAAP | Generally Accepted Accounting Principles |
| OPEB | Other Post-Retirement Employee Benefits |



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, on-going legal proceedings, 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 *Power the Future (*PTF) strategy, environmental compliance, transmission service, fuel costs and costs associated with the Midwest Independent Transmission System Operator, Inc. (MISO) Energy and Operating Reserve

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.

- 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 of 2005 and enforcement thereof by the Federal Energy Regulatory Commission (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; changes in the application of existing laws and regulations; and changes in the interpretation or enforcement of permit conditions by the permitting agencies.



- 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.

- Current and future litigation, regulatory investigations, proceedings or inquiries, including the pending lawsuit against the Wisconsin Energy Corporation Retirement Account Plan (Plan), FERC matters, and Internal Revenue Service audits and other tax matters.

- 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 trusts.

- The impact of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010.

- The effect of accounting pronouncements issued periodically by standard setting bodies, including any requirement for U.S. registrants to follow International Financial Reporting Standards instead of Generally Accepted Accounting Principles (GAAP).

- 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 Securities and Exchange Commission (SEC) filings or in other publicly disseminated written documents, including the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2009.

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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INTRODUCTION

Wisconsin Energy Corporation is a diversified holding company which conducts its operations primarily in two operating segments: 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 primary subsidiaries are Wisconsin Electric Power Company (Wisconsin Electric), Wisconsin Gas LLC (Wisconsin Gas) and W.E. Power, LLC (We Power).

Utility Energy Segment:

Our utility energy segment consists of: Wisconsin Electric, which serves electric customers in Wisconsin and the Upper Peninsula of Michigan, gas customers in Wisconsin and steam customers in metropolitan Milwaukee, Wisconsin; and Wisconsin Gas, which serves gas customers in Wisconsin. Wisconsin Electric and Wisconsin Gas operate under the trade name of "We Energies."

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 to Wisconsin Electric the new generating capacity included in our PTF strategy. See Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2009 Annual Report on Form 10-K for more information on PTF.

We have prepared the unaudited interim financial statements presented in this Form 10-Q pursuant to the rules and regulations of the SEC. We have condensed or omitted some information and note disclosures normally included in financial statements prepared in accordance with GAAP pursuant to these rules and regulations. This Form 10-Q, including the financial statements contained herein, should be read in conjunction with our 2009 Annual Report on Form 10-K, including the financial statements and notes therein.

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PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WISCONSIN ENERGY CORPORATION

CONSOLIDATED CONDENSED INCOME STATEMENTS

(Unaudited)

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Millions of Dollars, Except Per Share Amounts) | | | |
| Operating Revenues | $973.2 | $815.5 | $3,112.7 | $3,039.6 |
| Operating Expenses | | | | |
| Fuel and purchased power | 335.6 | 292.1 | 871.4 | 809.5 |
| Cost of gas sold | 67.4 | 63.2 | 519.0 | 667.9 |
| Other operation and maintenance | 318.1 | 299.7 | 971.0 | 935.1 |
| Depreciation and amortization | 77.4 | 86.5 | 228.6 | 257.1 |
| Property and revenue taxes | 26.9 | 27.5 | 79.8 | 82.9 |
| Total Operating Expenses | 825.4 | 769.0 | 2,669.8 | 2,752.5 |
| Amortization of Gain | 55.2 | 57.9 | 151.8 | 177.2 |
| Operating Income | 203.0 | 104.4 | 594.7 | 464.3 |
| Equity in Earnings of Transmission Affiliate | 15.2 | 14.9 | 45.5 | 43.6 |
| Other Income, net | 9.6 | 10.2 | 25.5 | 24.0 |
| Interest Expense, net | 52.5 | 38.4 | 154.9 | 119.0 |
| Income from Continuing Operations Before Income Taxes | 175.3 | 91.1 | 510.8 | 412.9 |
| Income Taxes | 63.0 | 32.9 | 182.0 | 150.3 |
| Income from Continuing Operations | 112.3 | 58.2 | 328.8 | 262.6 |
| Income (Loss) from Discontinued Operations, Net of Tax | (0.1) | 0.3 | 1.8 | 1.1 |
| Net Income | $112.2 | $58.5 | $330.6 | $263.7 |
| Earnings Per Share (Basic) | | | | |
| Continuing operations | $0.96 | $0.50 | $2.81 | $2.25 |
| Discontinued operations | - | - | 0.02 | 0.01 |
| Total Earnings Per Share (Basic) | $0.96 | $0.50 | $2.83 | $2.26 |
| Earnings Per Share (Diluted) | | | | |
| Continuing operations | $0.95 | $0.49 | $2.78 | $2.23 |
| Discontinued operations | - | 0.01 | 0.01 | 0.01 |
| Total Earnings Per Share (Diluted) | $0.95 | $0.50 | $2.79 | $2.24 |

| | | | | |
|---|---|---|---|---|
| Weighted Average Common | | | | |
| Shares Outstanding (Millions) | | | | |
| Basic | 116.9 | 116.9 | 116.9 | 116.9 |
| Diluted | 118.4 | 118.0 | 118.4 | 117.9 |
| Dividends Per Share of Common Stock | $0.40 | $0.3375 | $1.20 | $1.0125 |

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

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WISCONSIN ENERGY CORPORATION

CONSOLIDATED CONDENSED BALANCE SHEETS

| | (Unaudited) September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (Millions of Dollars) | |
| Assets | | |
| Property, Plant and Equipment | | |
| In service | $ 11,500.9 | $ 10,192.1 |
| Accumulated depreciation | (3,581.5) | (3,431.9) |
| | 7,919.4 | 6,760.2 |
| Construction work in progress | 1,414.2 | 2,185.1 |
| Leased facilities, net | 66.3 | 70.5 |
| Net Property, Plant and Equipment | 9,399.9 | 9,015.8 |
| Investments | | |
| Equity investment in transmission affiliate | 327.0 | 314.6 |
| Other | 38.2 | 44.1 |
| Total Investments | 365.2 | 358.7 |
| Current Assets | | |

| | | |
|---|---|---|
| Cash and cash equivalents | 11.2 | 20.2 |
| Restricted cash | 62.7 | 194.5 |
| Accounts receivable | 300.3 | 298.7 |
| Accrued revenues | 157.8 | 288.7 |
| Materials, supplies and inventories | 422.3 | 378.1 |
| Regulatory assets | 54.4 | 58.9 |
| Prepayments and other | 179.9 | 290.2 |
| Total Current Assets | 1,188.6 | 1,529.3 |
| Deferred Charges and Other Assets | | |
| Regulatory assets | 1,139.4 | 1,180.5 |
| Goodwill | 441.9 | 441.9 |
| Other | 183.5 | 171.7 |
| Total Deferred Charges and Other Assets | 1,764.8 | 1,794.1 |
| Total Assets | $ 12,718.5 | $ 12,697.9 |
| Capitalization and Liabilities | | |
| Capitalization | | |
| Common equity | $ 3,727.7 | $ 3,566.9 |
| Preferred stock of subsidiary | 30.4 | 30.4 |
| Long-term debt | 3,935.7 | 3,875.8 |
| Total Capitalization | 7,693.8 | 7,473.1 |
| Current Liabilities | | |
| Long-term debt due currently | 472.7 | 295.7 |
| Short-term debt | 518.6 | 825.1 |
| Accounts payable | 254.3 | 290.6 |
| Regulatory liabilities | 66.2 | 222.8 |
| Other | 297.6 | 259.9 |
| Total Current Liabilities | 1,609.4 | 1,894.1 |
| Deferred Credits and Other Liabilities | | |
| Regulatory liabilities | 880.1 | 876.0 |
| Deferred income taxes - long-term | 1,047.6 | 1,017.9 |
| Deferred revenue, net | 791.8 | 739.1 |
| Pension and other benefit obligations | 335.3 | 318.7 |
| Other | 360.5 | 379.0 |

| | | |
|---|---|---|
| Total Deferred Credits and Other Liabilities | 3,415.3 | 3,330.7 |
| Total Capitalization and Liabilities | $ 12,718.5 | $ 12,697.9 |

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



WISCONSIN ENERGY CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

| | | Nine Months Ended September 30 | |
|---|---|---|---|
| | | 2010 | 2009 |
| | | (Millions of Dollars) | |
| Operating Activities | | | |
| Net income | | $ 330.6 | $ 263.7 |
| Reconciliation to cash | | | |
| Depreciation and amortization | | 237.6 | 267.8 |
| Amortization of gain | | (151.8) | (177.2) |
| Equity in earnings of transmission affiliate | | (45.5) | (43.6) |
| Distributions from transmission affiliate | | 37.0 | 34.5 |
| Deferred income taxes and investment tax credits, net | | (1.0) | 121.9 |
| Deferred revenue | | 78.0 | 148.4 |
| Contributions to benefit plans | | - | (289.3) |
| Change in - | Accounts receivable and accrued revenues | 111.4 | 237.1 |
| | Inventories | (44.2) | (44.3) |
| | Other current assets | 37.8 | 61.8 |
| | Accounts payable | (39.8) | (188.6) |
| | Accrued income taxes, net | 2.3 | 22.2 |
| | Deferred costs, net | 19.5 | 34.6 |
| | Other current liabilities | 51.0 | 11.7 |
| Other, net | | 30.8 | (27.0) |

| | | |
|---|---|---|
| Cash Provided by Operating Activities | 653.7 | 433.7 |
| Investing Activities | | |
| Capital expenditures | (545.6) | (553.1) |
| Investment in transmission affiliate | (3.9) | (18.1) |
| Proceeds from asset sales, net | 63.8 | 15.7 |
| Change in restricted cash | 131.8 | 149.5 |
| Other, net | (56.1) | (70.0) |
| Cash Used in Investing Activities | (410.0) | (476.0) |
| Financing Activities | | |
| Exercise of stock options | 76.0 | 12.5 |
| Purchase of common stock | (128.5) | (21.0) |
| Dividends paid on common stock | (140.3) | (118.4) |
| Issuance of long-term debt | 530.0 | 11.5 |
| Retirement and repurchase of long-term debt | (289.9) | (202.0) |
| Change in short-term debt | (306.5) | 335.7 |
| Other, net | 6.5 | 2.0 |
| Cash (Used in) Provided by Financing Activities | (252.7) | 20.3 |
| Change in Cash and Cash Equivalents | (9.0) | (22.0) |
| Cash and Cash Equivalents at Beginning of Period | 20.2 | 31.7 |
| Cash and Cash Equivalents at End of Period | $ 11.2 | $ 9.7 |

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



WISCONSIN ENERGY CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1 -- GENERAL INFORMATION

Our accompanying unaudited consolidated condensed financial statements should be read in conjunction with Item 8, Financial Statements and Supplementary Data, in our 2009 Annual Report on Form 10-K. In the opinion of management, we have included all adjustments, normal and recurring in nature, necessary to a fair presentation of the results of operations, cash flows and financial position in the accompanying income statements, statements of cash flows and balance sheets. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results which may be expected for the entire fiscal year 2010 because of seasonal and other factors.

Reclassifications:

We have reclassified certain prior year financial statement amounts to conform to their current year presentation. These reclassifications had no effect on total assets, net income or earnings per share.

The reclassifications primarily relate to the reporting of discontinued operations reflecting the sale of Edison Sault. The footnotes contained herein reflect continuing operations for all periods presented. For further information, see Note 5 -- Discontinued Operations and Divestitures.

2 -- NEW ACCOUNTING PRONOUNCEMENTS

Amendments to Variable Interest Entity Consolidation Guidance:

In June 2009, the Financial Accounting Standards Board 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 did not have any impact on our financial condition, results of operations or cash flows. See Note 12 -- Variable Interest Entities for required disclosures.

3 -- 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, Port Washington Generating Station Unit 1 (PWGS 1), Port Washington Generating Station Unit 2 (PWGS 2) and Oak Creek expansion Unit 1 (OC 1), and is in the process of building another new generating unit, Oak Creek expansion Unit 2 (OC 2), which are, and will be, leased to our utility subsidiary, Wisconsin Electric, under long-term leases that have been approved by the Public Service Commission of Wisconsin (PSCW). The leases are designed to recover the capital costs of the plant, including a return. PWGS 1, PWGS 2 and OC 1 were placed in service in July 2005, May 2008 and February 2010, respectively. 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.

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 in 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 in 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 nine months ended September 30, 2010 and for the twelve months ended December 31, 2009. Capitalized interest is included in the total cost of the PTF units.



Plant in Service:

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 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 (consisting of the lease payments included in rates and the amortization of the deferred revenue) on a levelized basis over the term of the lease. We depreciate the units on a straight-line basis over their expected service life.

4 -- COMMON EQUITY

Share-Based Compensation Expense:

For a description of share-based compensation, including stock options, restricted stock and performance units, see Note J -- Common Equity in our 2009 Annual Report on Form 10-K. 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 outstanding stock options during the period. Shares purchased on the open market by our independent agents are currently used to satisfy share-based awards.

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:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Millions of Dollars) | | | |
| Stock options | $1.9 | $2.7 | $5.7 | $8.0 |
| Performance units | 10.3 | 5.7 | 20.9 | 9.6 |
| Restricted stock | 0.3 | 0.2 | 1.1 | 0.7 |

| | | | | |
|---|---|---|---|---|
| Share-based compensation expense | $12.5 | $8.6 | $27.7 | $18.3 |
| Related Tax Benefit | $5.0 | $3.4 | $11.1 | $7.3 |

Stock Option Activity:

During the first nine months of 2010, the Compensation Committee granted 274,750 stock options that had an estimated fair value of $6.72 per share. During the first nine months of 2009, the Compensation Committee granted 1,216,625 stock options that had an estimated fair value of $8.01 per share. The following assumptions were used to value the options using a binomial option pricing model:

| | 2010 | 2009 |
|---|---|---|
| Risk free interest rate | 0.2% - 3.9% | 0.3% - 2.5% |
| Dividend yield | 3.7% | 3.0% |
| Expected volatility | 20.3% | 25.9% |
| Expected forfeiture rate | 2.0% | 2.0% |
| Expected life (years) | 5.9 | 6.2 |

The risk-free interest rate is based on the U.S. Treasury interest rate whose term is consistent with the expected life of the stock options. Dividend yield, expected volatility, expected forfeiture rate and expected life assumptions are based on our historical experience.

The following is a summary of our stock option activity for the three and nine months ended September 30, 2010:



| Stock Options | Number of Options | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value (Millions) |
|---|---|---|---|---|
| Outstanding as of July 1, 2010 | 8,015,065 | $39.93 | | |
| Granted | - | $ - | | |
| Exercised | (1,071,093) | $31.25 | | |
| Forfeited | - | $ - | | |
| Outstanding as of September 30, 2010 | 6,943,972 | $41.27 | | |
| Outstanding as of January 1, 2010 | 9,087,315 | $38.49 | | |

| | | | | |
|---|---|---|---|---|
| Granted | 274,750 | $49.84 | | |
| Exercised | (2,413,093) | $31.79 | | |
| Forfeited | (5,000) | $45.70 | | |
| Outstanding as of September 30, 2010 | 6,943,972 | $41.27 | 6.0 | $114.8 |
| Exercisable as of September 30, 2010 | 4,206,482 | $38.38 | 4.7 | $81.7 |

The intrinsic value of options exercised was $26.8 million and $51.9 million for the three and nine months ended September 30, 2010, and $4.3 million and $8.2 million for the same periods in 2009, respectively. Cash received from options exercised was $76.0 million and $12.5 million for the nine months ended September 30, 2010 and 2009, respectively. The actual tax benefit realized for the tax deductions from option exercises for the same periods was approximately $20.2 million and $3.3 million, respectively.

All outstanding stock options to purchase shares of common stock were included in the computation of diluted earnings per share during the third quarter of 2010.

The following table summarizes information about stock options outstanding as of September 30, 2010:

| | Options Outstanding | | | Options Exercisable | | |
|---|---|---|---|---|---|---|
| | | Weighted-Average | | | Weighted-Average | |
| Range of Exercise Prices | Number of Options | Exercise Price | Remaining Contractual Life (Years) | Number of Options | Exercise Price | Remaining Contractual Life (Years) |
| $20.39 to $25.93 | 420,114 | $24.24 | 1.8 | 420,114 | $24.24 | 1.8 |
| $33.44 to $39.48 | 2,476,165 | $35.88 | 4.3 | 2,476,165 | $35.88 | 4.3 |
| $42.22 to $49.84 | 4,047,693 | $46.33 | 7.4 | 1,310,203 | $47.63 | 6.4 |
| | 6,943,972 | $41.27 | 6.0 | 4,206,482 | $38.38 | 4.7 |

The following table summarizes information about our non-vested options during the three and nine months ended September 30, 2010:

| Non-Vested Stock Options | Number of Options | Weighted-Average Fair Value |
|---|---|---|
| Non-vested as of July 1, 2010 | 2,737,490 | $ 8.53 |
| Granted | - | $ - |
| Vested | - | $ - |
| Forfeited | - | $ - |
| Non-vested as of September 30, 2010 | 2,737,490 | $ 8.53 |

| | | |
|---|---|---|
| Non-vested as of January 1, 2010 | 3,665,100 | $ 8.73 |
| Granted | 274,750 | $ 6.72 |
| Vested | (1,197,360) | $ 8.72 |
| Forfeited | (5,000) | $ 8.53 |
| Non-vested as of September 30, 2010 | 2,737,490 | $ 8.53 |

As of September 30, 2010, total compensation costs related to non-vested stock options not yet recognized was approximately $3.6 million, which is expected to be recognized over the next 12 months on a weighted-average basis.

13

Restricted Shares:

During the first nine months of 2010, the Compensation Committee granted 46,740 restricted shares to certain key employees and directors. These awards have a three-year vesting period, with, typically, one-third of the award vesting on each anniversary of the grant date. During the vesting period, restricted share recipients have voting rights and are entitled to dividends in the same manner as other shareholders.

The following restricted stock activity occurred during the three and nine months ended September 30, 2010:

| Restricted Shares | Number of Shares | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Outstanding as of July 1, 2010 | 126,865 | |
| Granted | - | |
| Released | (1,924) | $29.13 |
| Forfeited | - | $ - |
| Outstanding as of September 30, 2010 | 124,941 | |
| | | |
| Outstanding as of January 1, 2010 | 99,649 | |
| Granted | 46,740 | $49.55 |
| Released | (21,173) | $38.64 |
| Forfeited | (275) | $49.55 |
| Outstanding as of September 30, 2010 | 124,941 | |

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 $0.1 million and $1.1 million for the three and nine months ended September 30, 2010, and $0.1 million and $0.8 million for the same periods in 2009. The actual tax benefits realized for the tax deductions from released restricted shares was

$0.1 million and $0.3 million for the three and nine months ended September 30, 2010, and zero and $0.3 million for the same periods in 2009, respectively.

As of September 30, 2010, total compensation cost related to restricted stock not yet recognized was approximately $2.5 million, which is expected to be recognized over the next 26 months on a weighted-average basis.

Performance Units:

In January 2010 and 2009, the Compensation Committee granted 277,915 and 333,220 performance units, respectively, to officers and other key employees under the Wisconsin Energy Performance Unit Plan. Under the grants, the ultimate number of units that 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 unit award. All grants are settled in cash. We are accruing compensation costs over the three-year period based on our estimate of the final expected value of the awards. Performance units earned as of December 31, 2009 and 2008 vested and were settled during the first quarter of 2010 and 2009, and had a total intrinsic value of $9.8 million and $8.4 million, respectively. The actual tax benefit realized for the tax deductions from the settlement of performance units was approximately $3.4 million and $3.1 million, respectively. As of September 30, 2010, total compensation costs related to performance units not yet recognized was approximately $32.0 million, which is expected to be recognized over the next 22 months on a weighted-average basis.

***Restrictions:*** Wisconsin Energy's ability as a holding company to pay common dividends primarily depends on the availability of funds received from its non-utility subsidiary, We Power, and its utility subsidiaries. Various financing arrangements and regulatory requirements impose certain restrictions on the ability of our subsidiaries to transfer funds to us 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. See Note J --Common Equity in our 2009 Annual Report on Form 10-K for additional information on these and other restrictions.

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



Comprehensive Income:

Comprehensive income includes all changes in equity during a period except those resulting from investments by and distributions to owners.

Our total comprehensive income for the nine months ended September 30, 2010 and 2009 was $330.9 million and $264.0 million, respectively, which approximates net income for each of those periods.

## 5 -- DISCONTINUED OPERATIONS AND DIVESTITURES

Edison Sault Electric Company (Edison Sault):

Effective May 4, 2010, we sold Edison Sault to Cloverland Electric Cooperative for approximately $63.0 million. Prior to the sale, we transferred certain assets to Wisconsin Energy, including Edison Sault's membership interest in American Transmission Company, LLC (ATC).

The assets and liabilities ($77.0 million and $15.1 million, respectively) associated with Edison Sault were reclassified as held for sale within other current assets and liabilities on our Consolidated Condensed Balance Sheet as of December 31, 2009. We also reclassified the income related to Edison Sault as discontinued operations in the accompanying Consolidated Condensed Income Statements. Discontinued Edison Sault operations had no significant impact on our Consolidated Condensed Statements of Cash Flows for the nine months ended September 30, 2010 and 2009, respectively.

The following table summarizes the net impacts of the discontinued operations on our earnings as of September 30, 2010 and 2009:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 (a) | 2009 |
| | (Millions of Dollars) | | | |
| Income from Continuing Operations | $112.3 | $58.2 | $328.8 | $262.6 |
| Income from Discontinued Edison Sault operations, net of tax | - | 0.4 | 0.7 | 0.9 |
| Income from Discontinued other operations, net of tax | (0.1) | (0.1) | 1.1 | 0.2 |
| Net Income | $112.2 | $58.5 | $330.6 | $263.7 |

(a) As a result of its sale effective May 4, 2010, we owned Edison Sault for approximately four of the nine months ended September 30, 2010.

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 Wisconsin Power and Light Company, a subsidiary of Alliant Energy Corp., for our net book value, including working capital. In March 2010, the agreement became effective and we are in the process of receiving regulatory approvals. The completion of the sale is subject to approval by applicable regulatory bodies, including the FERC, PSCW and Michigan Public Service Commission (MPSC). In June 2010, we received approval for the sale from FERC. If approved by the remaining regulatory bodies, we expect the sale to close by the end of 2010 and to realize proceeds of between $40 million and $45 million depending on the working capital balances and our level of capital investment in the unit prior to the sale.

6 -- LONG TERM DEBT

In February 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.

7 -- 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 Over-the-Counter (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.

The following tables summarize our financial assets and liabilities by level within the fair value hierarchy:

| Recurring Fair Value Measures | As of September 30, 2010 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (Millions of Dollars) | | | |
| Assets: | | | | |
| Restricted Cash | $62.7 | $ - | $ - | $62.7 |
| Derivatives | 2.3 | 5.7 | 10.4 | 18.4 |
| Total | $65.0 | $5.7 | $10.4 | $81.1 |
| Liabilities: | | | | |
| Derivatives | $17.1 | $10.4 | $ - | $27.5 |
| Total | $17.1 | $10.4 | $ - | $27.5 |

| Recurring Fair Value Measures | As of December 31, 2009 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (Millions of Dollars) | | | |
| Assets: | | | | |
| Restricted Cash | $194.5 | $ - | $ - | $194.5 |
| Derivatives | 0.7 | 4.2 | 5.8 | 10.7 |
| Total | $195.2 | $4.2 | $5.8 | $205.2 |
| Liabilities: | | | | |
| Derivatives | $4.5 | $4.8 | $ - | $9.3 |
| Total | $4.5 | $4.8 | $ - | $9.3 |

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 Nuclear Power Plant (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 tables summarize the fair value of derivatives classified as Level 3 in the fair value hierarchy:

| | Quarter to Date | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Millions of Dollars) | | | |
| Beginning Balance | $15.9 | $15.4 | $5.8 | $8.8 |
| Realized and unrealized gains (losses) | - | - | - | - |
| Purchases, issuances and settlements | (5.5) | (5.3) | 4.6 | 1.3 |
| Transfers in and/or out of Level 3 | - | - | - | - |
| Balance as of September 30 | $10.4 | $10.1 | $10.4 | $10.1 |

| | | | | |
|---|---|---|---|---|
| Change in unrealized gains (losses) relating to instruments still held as of September 30 | $ - | $ - | $ - | $ - |

Derivative instruments reflected in Level 3 of the hierarchy include MISO Financial Transmission Rights (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 8 -- 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 are as follows:

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| Financial Instruments | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (Millions of Dollars) | | | |
| Preferred stock, no redemption required | $30.4 | $23.0 | $30.4 | $20.2 |
| Long-term debt including current portion | $4,289.9 | $4,669.6 | $4,049.8 | $4,162.5 |



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 on 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.

## 8 -- 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 September 30, 2010, we recognized $37.4 million in regulatory assets and $17.3 million in regulatory liabilities related to derivatives in comparison to $19.1 million in regulatory assets and $10.3 million in regulatory liabilities as of December 31, 2009.

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 $1.0 million is recorded in Other deferred charges and other assets and the long-term portion of our derivative liabilities of $1.8 million is recorded in Other deferred credits and other liabilities. Our Consolidated Condensed Balance Sheets as of September 30, 2010 and December 31, 2009 include:

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Derivative Asset | Derivative Liability | Derivative Asset | Derivative Liability |
| | (Millions of Dollars) | | | |
| Natural Gas | $3.8 | $27.5 | $2.2 | $9.3 |
| Fuel Oil | 2.3 | - | 0.6 | - |
| FTRs | 10.4 | - | 5.8 | - |
| Coal | 1.9 | - | 2.1 | - |
| Total | $18.4 | $27.5 | $10.7 | $9.3 |

Our Consolidated Condensed Income Statements include gains (losses) on derivative instruments used in our risk management strategies under Fuel and purchased power for those commodities supporting our electric operations and under Cost of gas sold for the natural gas sold to our customers. Our estimated notional volumes and gains (losses) for the three and nine months ended September 30, 2010 and 2009 follow:

| | Three Months Ended September 30, 2010 | | Three Months Ended September 30, 2009 | |
|---|---|---|---|---|
| | Volume | Gains (Losses) | Volume | Gains (Losses) |
| | | (Millions of Dollars) | | (Millions of Dollars) |
| Natural Gas | 17.4 million Dth | ($8.8) | 21.4 million Dth | ($26.4) |
| Power | 65,040 MWh | (0.5) | 8,400 MWh | - |
| Fuel Oil | 2.3 million gallons | (0.1) | 2.1 million gallons | (0.5) |
| FTRs | 6,584 MW | 4.4 | 6,561 MW | 1.3 |
| Total | | ($5.0) | | ($25.6) |



| | Nine Months Ended September 30, 2010 | | Nine Months Ended September 30, 2009 | |
|---|---|---|---|---|
| | Volume | Gains (Losses) | Volume | Gains (Losses) |
| | | (Millions of Dollars) | | (Millions of Dollars) |

| | | | | |
|---|---|---|---|---|
| Natural Gas | 65.0 million Dth | ($33.3) | 67.1 million Dth | ($80.0) |
| Power | 224,640 MWh | (0.5) | 23,520 MWh | (0.6) |
| Fuel Oil | 6.0 million gallons | (0.1) | 5.1 million gallons | (2.3) |
| FTRs | 18,673 MW | 16.2 | 21,132 MW | 6.1 |
| Total | | ($17.7) | | ($76.8) |

As of September 30, 2010 and December 31, 2009, we have posted collateral of $23.3 million and $9.3 million, respectively, in our margin accounts. These amounts are recorded on the balance sheets in Prepayments and other current assets.

9 -- BENEFITS

The components of our net periodic pension and Other Post-Retirement Employee Benefits (OPEB) costs for the three and nine months ended September 30, 2010 and 2009 were as follows:

| | Pension Costs | | | |
|---|---|---|---|---|
| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
| Benefit Plan Cost Components | 2010 | 2009 | 2010 | 2009 |
| | (Millions of Dollars) | | | |
| Net Periodic Benefit Cost | | | | |
| Service cost | $5.9 | $5.7 | $17.7 | $17.4 |
| Interest cost | 17.1 | 18.1 | 50.9 | 54.2 |
| Expected return on plan assets | (19.6) | (23.8) | (58.3) | (71.5) |
| Amortization of: | | | | |
| Prior service cost | 0.6 | 0.6 | 1.7 | 1.7 |
| Actuarial loss | 6.7 | 4.7 | 20.0 | 14.1 |
| Net Periodic Benefit Cost | $10.7 | $5.3 | $32.0 | $15.9 |

| | OPEB Costs | | | |
|---|---|---|---|---|
| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
| Benefit Plan Cost Components | 2010 | 2009 | 2010 | 2009 |
| | (Millions of Dollars) | | | |
| Net Periodic Benefit Cost | | | | |

| | | | | |
|---|---|---|---|---|
| Service cost | $2.8 | $2.2 | $8.4 | $6.5 |
| Interest cost | 5.3 | 5.1 | 15.8 | 15.4 |
| Expected return on plan assets | (3.6) | (3.4) | (10.8) | (10.2) |
| Amortization of: | | | | |
| Transition obligation | 0.1 | 0.1 | 0.3 | 0.2 |
| Prior service (credit) | (3.0) | (3.1) | (8.9) | (9.4) |
| Actuarial loss | 2.7 | 2.2 | 8.1 | 6.7 |
| Net Periodic Benefit Cost | $4.3 | $3.1 | $12.9 | $9.2 |

Postemployment Benefits:

Postemployment benefits provided to former or inactive employees are recognized when an event occurs. The estimated liability for such benefits was $16.0 million as of September 30, 2010 and $15.8 million as of December 31, 2009.

10 -- GUARANTEES

We enter into various guarantees to provide financial and performance assurance to third parties on behalf of our affiliates. As of September 30, 2010, we had the following guarantees:



| Maximum Potential Future Payments | Outstanding | Liability Recorded |
|---|---|---|
| | (Millions of Dollars) | |
| $3.6 | $0.7 | $ - |

We 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.

11 -- SEGMENT INFORMATION

Summarized financial information concerning our operating segments for the three and nine months ended September 30, 2010 and 2009 is shown in the following table:

| Wisconsin Energy Corporation | Operating Segments Energy Utility | Operating Segments Energy Non-Utility | Corporate & Other (a) & Reconciling Items | Total Consolidated |
|---|---|---|---|---|
| | (Millions of Dollars) | | | |
| Three Months Ended | | | | |
| September 30, 2010 | | | | |
| Operating Revenues (b) | $960.5 | $87.4 | ($74.7) | $973.2 |
| Depreciation and Amortization | $63.2 | $13.9 | $0.3 | $77.4 |
| Operating Income (Loss) | $134.2 | $69.0 | ($0.2) | $203.0 |
| Equity in Earnings of Unconsolidated Affiliates | $15.2 | $ - | ($0.1) | $15.1 |
| Interest Expense, Net | $29.2 | $11.0 | $12.3 | $52.5 |
| Income Tax Expense (Benefit) | $44.6 | $22.2 | ($3.8) | $63.0 |
| Loss from Discontinued Operations, Net of Tax | $ - | $ - | ($0.1) | ($0.1) |
| Net Income (Loss) | $84.7 | $36.3 | ($8.8) | $112.2 |
| Capital Expenditures | $149.2 | $16.6 | $0.7 | $166.5 |
| Three Months Ended | | | | |
| September 30, 2009 | | | | |
| Operating Revenues (b) | $811.1 | $44.3 | ($39.9) | $815.5 |
| Depreciation and Amortization | $79.0 | $7.3 | $0.2 | $86.5 |
| Operating Income (Loss) | $74.3 | $32.5 | ($2.4) | $104.4 |
| Equity in Earnings of Unconsolidated Affiliates | $14.9 | $ - | ($0.1) | $14.8 |
| Interest Expense, Net | $29.0 | $3.4 | $6.0 | $38.4 |
| Income Tax Expense (Benefit) | $24.3 | $11.6 | ($3.0) | $32.9 |
| Income (Loss) from Discontinued Operations, Net of Tax | $0.4 | $ - | ($0.1) | $0.3 |
| Net Income (Loss) | $46.0 | $17.4 | ($4.9) | $58.5 |
| Capital Expenditures | $127.2 | $62.4 | $0.1 | $189.7 |
| Nine Months Ended | | | | |
| September 30, 2010 | | | | |
| Operating Revenues (b) | $3,083.9 | $239.5 | ($210.7) | $3,112.7 |
| Depreciation and Amortization | $188.4 | $39.5 | $0.7 | $228.6 |
| Operating Income (Loss) | $410.1 | $188.0 | ($3.4) | $594.7 |

| | | | | |
|---|---|---|---|---|
| Equity in Earnings of Unconsolidated Affiliates | $45.5 | $ - | $ - | $45.5 |
| Interest Expense, Net | $88.9 | $28.9 | $37.1 | $154.9 |
| Income Tax Expense (Benefit) | $138.9 | $62.7 | ($19.6) | $182.0 |
| Income from Discontinued Operations, Net of Tax | $0.7 | $ - | $1.1 | $1.8 |
| Net Income (Loss) | $252.9 | $96.8 | ($19.1) | $330.6 |
| Total Assets (c) | $11,700.2 | $2,965.3 | ($1,947.0) | $12,718.5 |
| Capital Expenditures | $445.1 | $99.0 | $1.5 | $545.6 |



| | Operating Segments | | Corporate & | |
|---|---|---|---|---|
| | Energy | | Other (a) & Reconciling | Total |
| Wisconsin Energy Corporation | Utility | Non-Utility | Items | Consolidated |
| | | (Millions of Dollars) | | |
| Nine Months Ended | | | | |
| September 30, 2009 | | | | |
| Operating Revenues (b) | $3,031.9 | $125.1 | ($117.4) | $3,039.6 |
| Depreciation and Amortization | $234.8 | $21.8 | $0.5 | $257.1 |
| Operating Income (Loss) | $378.5 | $91.2 | ($5.4) | $464.3 |
| Equity in Earnings of Unconsolidated Affiliates | $43.6 | $ - | ($0.1) | $43.5 |
| Interest Expense, Net | $88.6 | $11.6 | $18.8 | $119.0 |
| Income Tax Expense (Benefit) | $127.5 | $33.5 | ($10.7) | $150.3 |
| Income (Loss) from Discontinued Operations, Net of Tax | $1.3 | $ - | ($0.2) | $1.1 |
| Net Income (Loss) | $229.8 | $47.9 | ($14.0) | $263.7 |
| Total Assets (c) | $10,539.5 | $2,688.3 | ($807.1) | $12,420.7 |
| Capital Expenditures | $400.4 | $147.1 | $5.6 | $553.1 |

(a) Other includes all other non-utility activities, primarily non-utility real estate investment and development by Wispark LLC, as well as interest on corporate debt.

(b) An elimination for intersegment revenues of $75.0 million and $39.9 million for the three months ended September 30, 2010 and 2009, respectively, and $211.2 million and $117.6 million for the nine months ended September 30, 2010 and 2009, respectively, is included in Operating Revenues.

(c) An elimination of $1,803.3 million and $883.4 million is included in Total Assets at September 30, 2010 and 2009, respectively, for PTF-related activity between We Power and Wisconsin Electric.

12 -- 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 which represent variable interests. We account for one of these agreements, with an independent power producer, as an operating lease. The agreement has a remaining term of three years. We have examined the risks of the entity including the impact of operations and maintenance, dispatch, financing, fuel costs, remaining useful life and other factors, and have determined that we are not the primary beneficiary of this entity. We have concluded that we do not have the power to direct the activities that would most significantly affect the economic performance of the entity over its remaining life.

We also have a purchased power agreement for 236 MW of firm capacity from a gas-fired cogeneration facility, which we account for as a capital lease. The agreement includes no minimum energy requirements over the remaining term of 13 years. We have examined the risks of the entity including operations and maintenance, dispatch, financing, fuel costs and other factors, and have determined that we are not the primary beneficiary of the entity. We do not hold an equity or debt interest in the entity and there is no residual guarantee associated with the purchased power agreement.

We have approximately $376.3 million of required payments over the remaining term of these agreements. We believe that the required lease payments under these contracts will continue to be recoverable in rates. Total capacity and lease payments under these contracts for the nine months ended September 30, 2010 were $49.6 million. Our maximum exposure to loss is limited to the capacity payments under the contracts.



13 -- COMMITMENTS AND CONTINGENCIES

Environmental Matters:

We periodically review our exposure for remediation costs as evidence becomes available indicating that our liability has changed. Given current information, 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.

Divestitures:

Over the past several years, we have sold various businesses and assets. In connection with these sales, we have agreed to provide the respective buyers with customary indemnification provisions including, but not limited to, certain environmental, asbestos and product liability matters. In addition, pursuant to the sale of Point Beach, we have agreed to indemnification provisions customary to transactions involving the sale of nuclear assets. We have established reserves as deemed appropriate for these indemnification provisions.

Income Taxes:

During the first nine months of 2010, our federal unrecognized tax benefits decreased by $12.3 million as the result of payment of a tax obligation for a prior year.

## 14 -- SUPPLEMENTAL CASH FLOW INFORMATION

During the nine months ended September 30, 2010, we paid $101.2 million in interest, net of amounts capitalized, and $162.0 million in income taxes, net of refunds. During the nine months ended September 30, 2009, we paid $70.4 million in interest, net of amounts capitalized, and $1.9 million in income taxes, net of refunds.

As of September 30, 2010 and 2009, the amount of accounts payable related to capital expenditures was $18.2 million and $56.6 million, respectively.



# ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## RESULTS OF OPERATIONS -- THREE MONTHS ENDED SEPTEMBER 30, 2010

### CONSOLIDATED EARNINGS

The following table compares our operating income by business segment and our net income during the third quarter of 2010 with the third quarter of 2009 including favorable (better (B)) or unfavorable (worse (W)) variances:

| | Three Months Ended September 30 | | |
|---|---|---|---|
| | 2010 | B (W) | 2009 |
| | | (Millions of Dollars) | |
| Utility Energy Segment | $134.2 | $59.9 | $74.3 |

| | | | |
|---|---|---|---|
| Non-Utility Energy Segment | 69.0 | 36.5 | 32.5 |
| Corporate and Other | (0.2) | 2.2 | (2.4) |
| Total Operating Income | 203.0 | 98.6 | 104.4 |
| Equity in Earnings of Transmission Affiliate | 15.2 | 0.3 | 14.9 |
| Other Income, net | 9.6 | (0.6) | 10.2 |
| Interest Expense, net | 52.5 | (14.1) | 38.4 |
| Income from Continuing Operations Before Income Taxes | 175.3 | 84.2 | 91.1 |
| Income Taxes | 63.0 | (30.1) | 32.9 |
| Income from Continuing Operations | 112.3 | 54.1 | 58.2 |
| Income (Loss) from Discontinued Operations, Net of Tax | (0.1) | (0.4) | 0.3 |
| Net Income | $112.2 | $53.7 | $58.5 |
| Diluted Earnings Per Share | $0.95 | $0.45 | $0.50 |

UTILITY ENERGY SEGMENT CONTRIBUTION TO OPERATING INCOME

Our utility energy segment contributed $134.2 million of operating income during the third quarter of 2010, an increase of $59.9 million, or 80.6%, compared with the third quarter of 2009. The following table summarizes the operating income of this segment between the comparative quarters:

| | Three Months Ended September 30 | | |
|---|---|---|---|
| Utility Energy Segment | 2010 | B (W) | 2009 |
| | | (Millions of Dollars) | |
| Operating Revenues | | | |
| Electric | $827.2 | $144.5 | $682.7 |
| Gas | 127.4 | 4.9 | 122.5 |
| Other | 5.9 | - | 5.9 |
| Total Operating Revenues | 960.5 | 149.4 | 811.1 |
| Fuel and Purchased Power | 336.8 | (43.6) | 293.2 |
| Cost of Gas Sold | 67.4 | (4.2) | 63.2 |
| Gross Margin | 556.3 | 101.6 | 454.7 |
| Other Operating Expenses | | | |
| Other Operation and Maintenance | 387.5 | (55.7) | 331.8 |
| Depreciation and Amortization | 63.2 | 15.8 | 79.0 |
| Property and Revenue Taxes | 26.6 | 0.9 | 27.5 |

| | | | |
|---|---|---|---|
| Total Operating Expenses | 881.5 | (86.8) | 794.7 |
| Amortization of Gain | 55.2 | (2.7) | 57.9 |
| Operating Income | $134.2 | $59.9 | $74.3 |

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Electric Utility Revenues and Sales

The following table compares electric utility operating revenues and MWh sales by customer class during the third quarter of 2010 with the third quarter of 2009:

| | Three Months Ended September 30 | | | | | |
|---|---|---|---|---|---|---|
| | Electric Revenues | | | MWh Sales | | |
| Electric Utility Operations | 2010 | B (W) | 2009 | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | | (Thousands) | | |
| Customer Class | | | | | | |
| Residential | $329.3 | $86.8 | $242.5 | 2,508.5 | 524.6 | 1,983.9 |
| Small Commercial/Industrial | 251.8 | 26.6 | 225.2 | 2,414.4 | 137.5 | 2,276.9 |
| Large Commercial/Industrial | 188.0 | 25.0 | 163.0 | 2,703.6 | 268.4 | 2,435.2 |
| Other - Retail | 5.0 | 0.1 | 4.9 | 35.6 | 0.3 | 35.3 |
| Total Retail | 774.1 | 138.5 | 635.6 | 7,662.1 | 930.8 | 6,731.3 |
| Wholesale - Other | 35.6 | 10.5 | 25.1 | 536.6 | 296.3 | 240.3 |
| Resale - Utilities | 10.8 | 3.1 | 7.7 | 193.2 | (89.3) | 282.5 |
| Other Operating Revenues | 6.7 | (7.6) | 14.3 | - | - | - |
| Total | $827.2 | $144.5 | $682.7 | 8,391.9 | 1,137.8 | 7,254.1 |

Weather -- Degree Days (a)

| | | | |
|---|---|---|---|
| Heating (127 Normal) | 118 | (6) | 124 |
| Cooling (517 Normal) | 733 | 392 | 341 |

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

Our electric utility operating revenues increased by $144.5 million, or 21.2%, when compared to the third quarter of 2009. The most significant factors that caused a change in revenues were:

- Favorable weather that increased electric revenues by an estimated $94.5 million as compared to the third quarter of 2009.
- Net pricing increases totaling $44.0 million related to Wisconsin and Michigan rate orders that became effective in 2010. For information on these rate orders, see Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters.
- Net economic growth that increased electric revenues by an estimated $12.2 million as compared to the third quarter of 2009.
- 2010 pricing increases totaling approximately $2.7 million, reflecting the reduction of Point Beach bill credits to retail customers.

As measured by cooling degree days, the third quarter of 2010 was 115.0% warmer than the same period in 2009 and 41.8% warmer than normal. Collectively, retail sales to our residential and small commercial and industrial customers, who are more weather sensitive, increased by 15.5%. Sales to our large commercial and industrial customers increased by 11.0% during the third quarter of 2010 as compared to the same period in 2009, primarily because of an improving economy. Electric sales to our largest customers, two iron ore mines, increased significantly for the quarter. If these sales are excluded, sales to our large commercial and industrial customers increased by 4.1% for the third quarter of 2010 as compared to the third quarter of 2009. The $7.6 million decline in Other Operating Revenues primarily relates to regulatory amortizations during the third quarter of 2010 as compared to the same period in 2009.

Fuel and Purchased Power

Our fuel and purchased power costs increased by $43.6 million, or 14.9%, when compared to the third quarter of 2009. This increase was primarily caused by the 15.7% increase in total MWh sales, partially offset by a 0.9% decrease in the average cost/MWh between periods. The average cost/MWh was comparable between periods because of a 14.8% increase in generation from our lower cost coal units, which was sufficient to offset the impact of a 5.9% increase in coal and transportation costs and the increased cost of purchased power utilized as a result of the increased sales.



Gas Utility Revenues, Gross Margin and Therm Deliveries

A comparison follows of gas utility operating revenues, gross margin and gas deliveries during the third quarter of 2010 with the third quarter of 2009. We believe gross margin is a better performance indicator than revenues because changes in the cost of gas sold flow through to revenue under gas cost recovery mechanisms. Between the comparative periods, total gas operating revenues increased by $4.9 million, or 4.0%, primarily because of higher natural gas prices.

Three Months Ended September 30

| | 2010 | B (W) | 2009 |
|---|---|---|---|
| | (Millions of Dollars) | | |
| Gas Operating Revenues | $127.4 | $4.9 | $122.5 |
| Cost of Gas Sold | 67.4 | (4.2) | 63.2 |
| Gross Margin | $60.0 | $0.7 | $59.3 |

The following table compares gas utility gross margin and natural gas therm deliveries by customer class during the third quarter of 2010 with the third quarter of 2009:

| | Three Months Ended September 30 | | | | | |
|---|---|---|---|---|---|---|
| | Gross Margin | | | Therm Deliveries | | |
| Gas Utility Operations | 2010 | B (W) | 2009 | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | | (Millions) | | |
| Customer Class | | | | | | |
| Residential | $37.4 | $0.9 | $36.5 | 45.0 | (4.4) | 49.4 |
| Commercial/Industrial | 10.1 | (0.2) | 10.3 | 32.0 | (1.3) | 33.3 |
| Interruptible | 0.4 | - | 0.4 | 3.2 | 0.4 | 2.8 |
| Total Retail | 47.9 | 0.7 | 47.2 | 80.2 | (5.3) | 85.5 |
| Transported Gas | 11.2 | 0.5 | 10.7 | 227.6 | 40.9 | 186.7 |
| Other | 0.9 | (0.5) | 1.4 | - | - | - |
| Total | $60.0 | $0.7 | $59.3 | 307.8 | 35.6 | 272.2 |
| Weather -- Degree Days (a) | | | | | | |
| Heating (127 Normal) | | | | 118 | (6) | 124 |

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

Our gas margins are seasonal and are primarily driven by the heating needs of our customers. The third quarter gas margins are historically the lowest of the year because of the lack of heating load. Our gas margins increased by $0.7 million, or 1.2%, when compared to the third quarter of 2009.

Other Operation and Maintenance Expense

Our other operation and maintenance expense increased by $55.7 million, or approximately 16.8%, when compared to the third quarter of 2009. The 2010 PSCW rate case order allowed for pricing increases related to regulatory items including PTF lease costs, bad debt expense and amortization of other deferred costs. We estimate that these items were approximately $19.3 million higher in the third quarter of 2010 as compared to the same period in 2009. In addition, operation and maintenance expenses at our power plants increased approximately $18.1 million primarily because of the operation of OC 1, which was placed in service in February 2010, and higher maintenance costs at our other power plants.

Depreciation and Amortization Expense

Our depreciation and amortization expense decreased by $15.8 million, or approximately 20.0%, when compared to the third quarter of 2009, primarily because of new depreciation rates that were implemented in connection with the 2010 PSCW rate case order. The new depreciation rates generally reflect longer lives for our utility assets.

Amortization of Gain

In connection with the September 2007 sale of Point Beach, we reached an agreement 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 to customers. When the bill credits are issued to customers, we transfer cash from the restricted accounts to the unrestricted accounts, adjusted for taxes. During the third quarter of 2010 and 2009, the Amortization of Gain was $55.2 million and $57.9 million, respectively. We expect that all remaining bill credits will be issued by December 31, 2010.

NON-UTILITY ENERGY SEGMENT CONTRIBUTION TO OPERATING INCOME

Our non-utility energy segment consists primarily of our PTF units (PWGS 1, PWGS 2, OC 1 and OC 2). PWGS 1 and 2 were placed in service in July 2005 and May 2008, respectively. The common facilities associated with the Oak Creek expansion consist of the water intake system, which was placed in service in January 2009, and the coal handling system and other smaller assets, which were placed in service prior to January 2009. OC 1 was placed in service in February 2010. We expect OC 2 to be placed in service during the fourth quarter of 2010; the guaranteed in-service date for OC 2 is November 28, 2010.

The table below reflects a full quarter's earnings for 2010 and 2009 for PWGS 1 and 2 and the common facilities for the Oak Creek expansion. It also reflects a full quarter's earnings for 2010 for OC 1. This segment reflects the lease revenues on these units, as well as the depreciation expense. The operating and maintenance costs associated with the plants are the responsibility of Wisconsin Electric and are recorded in the utility segment.

| | Quarter Ended September 30, 2010 (Millions of Dollars) | | | |
|---|---|---|---|---|
| | Port Washington | Oak Creek Expansion | All Other | Total |
| Operating Revenues | $26.1 | $54.0 | $7.3 | $87.4 |
| Operation and Maintenance Expense | 0.2 | 0.6 | 3.7 | 4.5 |
| Depreciation Expense | 4.9 | 8.6 | 0.4 | 13.9 |
| Operating Income | $21.0 | $44.8 | $3.2 | $69.0 |

Quarter Ended September 30, 2009

| | (Millions of Dollars) | | | |
|---|---|---|---|---|
| | Port Washington | Oak Creek Expansion | All Other | Total |
| Operating Revenues | $26.0 | $11.9 | $6.4 | $44.3 |
| Operation and Maintenance Expense | 0.1 | 0.9 | 3.5 | 4.5 |
| Depreciation Expense | 5.0 | 2.0 | 0.3 | 7.3 |
| Operating Income | $20.9 | $9.0 | $2.6 | $32.5 |

CONSOLIDATED INTEREST EXPENSE, NET

| | Three Months Ended September 30 | | |
|---|---|---|---|
| Interest Expense | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | |
| Gross Interest Costs | $65.6 | ($7.6) | $58.0 |
| Less: Capitalized Interest | 13.1 | (6.5) | 19.6 |
| Interest Expense, net | $52.5 | ($14.1) | $38.4 |

Our gross interest costs increased by $7.6 million, or 13.1%, during the third quarter of 2010, primarily because of higher long-term debt balances compared to the same period in 2009. In February 2010, we issued $530 million of long-term debt in connection with the commercial operation of OC 1 and used the net proceeds to repay short-term debt incurred during construction. Our capitalized interest decreased by $6.5 million primarily because we stopped capitalizing interest on OC 1 when it was placed in service in February 2010. As a result, our net interest expense increased by $14.1 million, or 36.7%, as compared to the third quarter of 2009.



CONSOLIDATED INCOME TAXES

For the third quarter of 2010, our effective tax rate applicable to continuing operations was 35.9% compared to 36.1% for the third quarter of 2009. For additional information, see Note H -- Income Taxes in our 2009 Annual Report on Form 10-K.

RESULTS OF OPERATIONS -- NINE MONTHS ENDED SEPTEMBER 30, 2010

CONSOLIDATED EARNINGS

The following table compares our operating income by business segment and our net income during the first nine months of 2010 with the first nine months of 2009 including favorable (better (B)) or unfavorable (worse (W)) variances:

| | Nine Months Ended September 30 | | |
|---|---|---|---|
| | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | |
| Utility Energy Segment | $410.1 | $31.6 | $378.5 |
| Non-Utility Energy Segment | 188.0 | 96.8 | 91.2 |
| Corporate and Other | (3.4) | 2.0 | (5.4) |
| Total Operating Income | 594.7 | 130.4 | 464.3 |
| Equity in Earnings of Transmission Affiliate | 45.5 | 1.9 | 43.6 |
| Other Income, net | 25.5 | 1.5 | 24.0 |
| Interest Expense, net | 154.9 | (35.9) | 119.0 |
| Income from Continuing Operations Before Income Taxes | 510.8 | 97.9 | 412.9 |
| Income Taxes | 182.0 | (31.7) | 150.3 |
| Income from Continuing Operations | 328.8 | 66.2 | 262.6 |
| Income from Discontinued Operations, Net of Tax | 1.8 | 0.7 | 1.1 |
| Net Income | $330.6 | $66.9 | $263.7 |
| Diluted Earnings Per Share | $2.79 | $0.55 | $2.24 |

UTILITY ENERGY SEGMENT CONTRIBUTION TO OPERATING INCOME

Our utility energy segment contributed $410.1 million of operating income during the first nine months of 2010, an increase of $31.6 million, or 8.3%, compared with the first nine months of 2009. The following table summarizes the operating income of this segment between the comparative periods:

| | Nine Months Ended September 30 | | |
|---|---|---|---|
| Utility Energy Segment | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | |
| Operating Revenues | | | |
| Electric | $2,232.7 | $220.1 | $2,012.6 |

| | | | |
|---|---|---|---|
| Gas | 823.7 | (167.3) | 991.0 |
| Other | 27.5 | (0.7) | 28.2 |
| Total Operating Revenues | 3,083.9 | 52.1 | 3,031.8 |
| Fuel and Purchased Power | 875.0 | (62.0) | 813.0 |
| Cost of Gas Sold | 519.0 | 148.9 | 667.9 |
| Gross Margin | 1,689.9 | 139.0 | 1,550.9 |
| Other Operating Expenses | | | |
| Other Operation and Maintenance | 1,164.1 | (131.9) | 1,032.2 |
| Depreciation and Amortization | 188.4 | 46.4 | 234.8 |
| Property and Revenue Taxes | 79.1 | 3.5 | 82.6 |
| Total Operating Expenses | 2,825.6 | 4.9 | 2,830.5 |
| Amortization of Gain | 151.8 | (25.4) | 177.2 |
| Operating Income | $410.1 | $31.6 | $378.5 |



The increase in Operating Income for the nine months ended September 30, 2010 as compared to the same period in 2009 was primarily caused by favorable weather during 2010, partially offset by unfavorable recoveries of revenues associated with fuel and purchased power and milder winter weather in 2010. During the first nine months of 2010, we experienced unfavorable fuel recoveries of approximately $64 million. During the same period in 2009, we experienced favorable fuel recoveries of approximately $2 million. Although we received a fuel order from the PSCW in March 2010 allowing us to increase our rates on an interim basis, we expect to be in an unfavorable fuel recovery position for 2010. For additional information on the fuel order, see Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters - 2010 Fuel Recovery Request.

Electric Utility Revenues and Sales

The following table compares electric utility operating revenues and MWh sales by customer class during the first nine months of 2010 with the first nine months of 2009:

| | Nine Months Ended September 30 | | | | | |
|---|---|---|---|---|---|---|
| | Electric Revenues | | | MWh Sales | | |
| Electric Utility Operations | 2010 | B (W) | 2009 | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | | (Thousands) | | |
| Customer Class | | | | | | |
| Residential | $842.1 | $114.2 | $727.9 | 6,383.7 | 484.9 | 5,898.8 |
| Small Commercial/Industrial | 699.3 | 42.4 | 656.9 | 6,708.4 | 159.4 | 6,549.0 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Large Commercial/Industrial | 514.4 | 65.8 | 448.6 | 7,526.5 | 748.0 | 6,778.5 |
| Other - Retail | 15.8 | 0.4 | 15.4 | 111.8 | (0.9) | 112.7 |
| Total Retail | 2,071.6 | 222.8 | 1,848.8 | 20,730.4 | 1,391.4 | 19,339.0 |
| Wholesale - Other | 107.1 | 20.0 | 87.1 | 1,572.9 | 450.8 | 1,122.1 |
| Resale - Utilities | 34.2 | 2.7 | 31.5 | 869.8 | (104.3) | 974.1 |
| Other Operating Revenues | 19.8 | (25.4) | 45.2 | - | - | - |
| Total | $2,232.7 | $220.1 | $2,012.6 | 23,173.1 | 1,737.9 | 21,435.2 |
| | | | | | | |
| Weather -- Degree Days (a) | | | | | | |
| Heating ( 4,320 Normal) | | | | 3,933 | (595) | 4,528 |
| Cooling ( 688 Normal) | | | | 941 | 466 | 475 |

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

Our electric utility operating revenues increased by $220.1 million, or 10.9%, when compared to the first nine months of 2009. The most significant factors that caused a change in revenues were:

- Favorable weather that increased electric revenues by an estimated $100.6 million as compared to the first nine months of 2009.
- Net pricing increases totaling $81.2 million related to Wisconsin and Michigan rate orders that became effective in 2010. For information on these rate orders, see Factors Affecting Results, Liquidity and Capital Resources -- Utility Rates and Regulatory Matters.
- Net economic growth that increased electric revenues by an estimated $34.9 million as compared to the first nine months of 2009.
- 2010 pricing increases totaling approximately $25.4 million, reflecting the reduction of Point Beach bill credits to retail customers.

As measured by cooling degree days, the first nine months of 2010 were 98.1% warmer than the same period in 2009 and 36.8% warmer than normal. Collectively, retail sales to our residential and small commercial and industrial customers, who are more weather sensitive, increased by 5.2%. Sales to our large commercial and industrial customers increased by 11.0% during the first nine months of 2010 as compared to the same period in 2009, primarily because of an improving economy. Electric sales to our largest customers, two iron ore mines, increased significantly for the first nine months of the year. If these sales are excluded, sales to our large commercial and industrial customers increased by 3.9% for the first nine months of 2010 as compared to the first nine months of 2009. The $25.4 million decline in Other Operating Revenues primarily relates to regulatory amortizations during the first nine months of 2010 as compared to the same period in 2009.



Fuel and Purchased Power

Our fuel and purchased power costs increased by $62.0 million, or 7.6%, when compared to the first nine months of 2009. This increase was primarily caused by the 8.1% increase in MWh sales, partially offset by a 0.4% decrease in the average cost/MWh between periods. The average cost/MWh was comparable between periods because of a 12.7% increase in generation from our lower cost coal units, which was sufficient to offset the impact of a 5.4% increase in coal and transportation costs and the increased cost of purchased power utilized as a result of the increased sales.

Gas Utility Revenues, Gross Margin and Therm Deliveries

A comparison follows of gas utility operating revenues, gross margin and gas deliveries during the first nine months of 2010 with the first nine months of 2009. We believe gross margin is a better performance indicator than revenues because changes in the cost of gas sold flow through to revenue under gas cost recovery mechanisms. Between the comparative periods, total gas operating revenues decreased by $167.3 million, or 16.9%, primarily because of lower natural gas prices and milder weather.

| | Nine Months Ended September 30 | | |
|---|---|---|---|
| | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | |
| Gas Operating Revenues | $823.7 | ($167.3) | $991.0 |
| Cost of Gas Sold | 519.0 | 148.9 | 667.9 |
| Gross Margin | $304.7 | ($18.4) | $323.1 |

The following table compares gas utility gross margin and natural gas therm deliveries by customer class during the first nine months of 2010 with the first nine months of 2009:

| | Nine Months Ended September 30 | | | | | |
|---|---|---|---|---|---|---|
| | Gross Margin | | | Therm Deliveries | | |
| Gas Utility Operations | 2010 | B (W) | 2009 | 2010 | B (W) | 2009 |
| | (Millions of Dollars) | | | (Millions) | | |
| Customer Class | | | | | | |
| Residential | $194.6 | ($11.4) | $206.0 | 484.9 | (66.0) | 550.9 |
| Commercial/Industrial | 64.7 | (8.1) | 72.8 | 282.8 | (45.9) | 328.7 |
| Interruptible | 1.6 | 0.2 | 1.4 | 14.6 | 0.8 | 13.8 |
| Total Retail | 260.9 | (19.3) | 280.2 | 782.3 | (111.1) | 893.4 |
| Transported Gas | 37.7 | 1.7 | 36.0 | 702.1 | 43.2 | 658.9 |
| Other | 6.1 | (0.8) | 6.9 | - | - | - |
| Total | $304.7 | ($18.4) | $323.1 | 1,484.4 | (67.9) | 1,552.3 |
| Weather -- Degree Days (a) | | | | | | |
| Heating (4,320 Normal) | | | | 3,933 | (595) | 4,528 |

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

Our gas margins decreased by $18.4 million, or approximately 5.7%, when compared to the first nine months of 2009, primarily because of a decline in sales volumes as a result of warmer winter weather in 2010 as compared to 2009. As measured by heating degree days, the first nine months of 2010 were 13.1% warmer than the same period in 2009 and 9.0% warmer than normal.

Other Operation and Maintenance Expense

Our other operation and maintenance expense increased by approximately $131.9 million, or 12.8%, when compared to the first nine months of 2009. The 2010 PSCW rate case order allowed for pricing increases related to regulatory items including PTF lease costs, bad debt expense and amortization of other deferred costs. We estimate that these items were approximately $62.7 million higher in the first nine months of 2010 as compared to the same period in 2009. In addition, operation and maintenance expenses at our power plants increased approximately $42.6 million primarily because of the operation of OC 1, which was placed in service in February 2010, and higher maintenance costs at our other power plants.



Depreciation and Amortization Expense

Our depreciation and amortization expense decreased by $46.4 million, or approximately 19.8%, when compared to the first nine months of 2009, primarily because of new depreciation rates that were implemented in connection with the 2010 PSCW rate case order. The new depreciation rates generally reflect longer lives for our utility assets.

Amortization of Gain

During the first nine months of 2010 and 2009, the Amortization of Gain was $151.8 million and $177.2 million, respectively. For 2010, we expect to see a reduction in the Amortization of Gain of approximately $34.6 million as compared to 2009 because of the scheduled decrease in Point Beach bill credits. We expect that all remaining Point Beach bill credits will be issued by December 31, 2010.

NON-UTILITY ENERGY SEGMENT CONTRIBUTION TO OPERATING INCOME

The table below reflects nine months of earnings for 2010 and 2009 for PWGS 1 and 2 and the common facilities for the Oak Creek expansion. It also reflects eight months of earnings in 2010 for OC 1. This segment reflects the lease revenues on these units, as well as the depreciation expense. The operating and maintenance costs associated with the plants are the responsibility of Wisconsin Electric and are recorded in the utility segment.

| | Nine Months Ended September 30, 2010 (Millions of Dollars) | | | |
|---|---|---|---|---|
| | Port Washington | Oak Creek Expansion | All Other | Total |
| Operating Revenues | $78.6 | $149.4 | $11.5 | $239.5 |
| Operation and Maintenance Expense | | | | |