WISCONSIN ENERGY CORP
Form 10-Q
August 01, 2007

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

# June 30, 2007

| 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ].

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 (June 30, 2007):

Common Stock, $.01 Par Value, 116,948,339 shares outstanding.

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WISCONSIN ENERGY CORPORATION

FORM 10-Q REPORT FOR THE QUARTER ENDED JUNE 30, 2007

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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 Subsidiaries | |
| 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 |
| Point Beach | Point Beach Nuclear Plant |
| PWGS | Port Washington Generating Station |
| PWGS 1 | Port Washington Generating Station Unit 1 |
| PWGS 2 | Port Washington Generating Station Unit 2 |
| | |
| Other Affiliates and Subsidiaries | |
| Minergy | Minergy Corp. |
| NMC | Nuclear Management Company, LLC |
| Wispark | Wispark LLC |

Federal and State Regulatory Agencies

| | |
|---|---|
| EPA | United States Environmental Protection Agency |
| FAA | Federal Aviation Administration |
| FERC | Federal Energy Regulatory Commission |
| 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

| | |
|---|---|
| BTA | Best Technology Available |
| CAIR | Clean Air Interstate Rule |
| $CO_2$ | Carbon Dioxide |
| CWA | Clean Water Act |
| NAAQS | National Ambient Air Quality Standards |
| $NO_X$ | Nitrogen Oxide |
| $PM_{2.5}$ | Fine Particulate Matter |
| SIP | State Implementation Plans |
| $SO_2$ | Sulfur Dioxide |
| WPDES | Wisconsin Pollution Discharge Elimination System |



## 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.

Other Terms and Abbreviations

| | |
|---|---|
| ALJ | Wisconsin Administrative Law Judge |
| Compensation Committee | Compensation Committee of the Board of Directors |
| CPCN | Certificate of Public Convenience and Necessity |
| FPL | FPL Group, Inc. |
| 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. |
| MISO Midwest Market | MISO bid-based energy market |
| Moody's | Moody's Investor Services |
| PTF | Power the Future |
| PSEG | Public Service Enterprise Group |
| RCC | Replacement Capital Covenant dated May 11, 2007 |
| RTO | Regional Transmission Organizations |
| S&P | Standard & Poors Corporation |
| UI | The United Illuminating Company |

Measurements

| | |
|---|---|
| MW | Megawatt(s) (One MW equals one million watts) |
| MWh | Megawatt-hour(s) |

Accounting Terms

| | |
|---|---|
| AFUDC | Allowance for Funds Used During Construction |
| CWIP | Construction Work in Progress |
| FASB | Financial Accounting Standards Board |
| FIN | FASB Interpretation |
| GAAP | Generally Accepted Accounting Principles |
| OPEB | Other Post-Retirement Employee Benefits |
| SFAS | Statement of Financial Accounting Standards |

Accounting Pronouncements

| | |
|---|---|
| FIN 46 | Consolidation of Variable Interest Entities |
| FIN 48 | Accounting for Uncertainty in Income Taxes |
| SFAS 109 | Accounting for Income Taxes |
| SFAS 123R | Share-Based Payment (Revised 2004) |
| SFAS 133 | Accounting for Derivative Instruments and Hedging Activities |
| SFAS 149 | Amendment of SFAS 133 on Derivative Instruments and Hedging Activities |
| SFAS 157 | Fair Value Measurements |
| SFAS 159 | The Fair Value Option for Financial Assets and Financial Liabilities |

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements contained in this report and other documents or oral presentations are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. 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 completion of construction projects, regulatory matters, fuel costs, sources of electric energy supply, the proposed sale of Point Beach, 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," "intends," "may," "objectives," "plans," "possible," "potential," "projects" 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, nuclear 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; nuclear or environmental incidents; resolution of used nuclear fuel storage and disposal issues; electric transmission or gas pipeline system constraints; unanticipated organizational structure or key personnel changes; collective bargaining agreements with union employees or work stoppages; inflation rates; or demographic and economic factors affecting utility service territories or operating environment.

- Regulatory factors such as unanticipated changes in rate-setting policies or procedures; unanticipated changes in regulatory accounting policies and practices; industry restructuring initiatives; transmission or distribution system operation and/or administration initiatives; recovery of costs of previous investments made under traditional regulation; recovery of costs associated with adoption of changed accounting standards; required changes in facilities or operations to reduce the risks or impacts of potential terrorist activities; required approvals for new construction; changes in the NRC's regulations related to Point Beach or a permanent repository for used nuclear fuel; changes in the regulations of the EPA as well as the WDNR, the Michigan Department of Natural Resources or the Michigan Department of Environmental Quality, including but not limited to regulations relating to the release of emissions from fossil-fueled power plants such as $CO_2$, $SO_2$, $NO_x$, small particulates or mercury, water quality and lead paint; and regulations relating to the intake and discharge of water; the siting approval process for new generation and transmission facilities; recovery of costs associated with implementation of a bid-based energy market; or changes in the regulations from the WDNR related to the siting approval process for new pipeline construction.

- The changing electric and gas utility environment as market-based forces replace strict industry regulation and other competitors enter the electric and gas markets resulting in increased wholesale and retail competition.

- Unanticipated operational and/or financial consequences related to implementation of the MISO Midwest Market that started in April 2005.
- Consolidation of the industry as a result of the combination and acquisition of utilities in the Midwest, nationally and globally as a result of the repeal of the Public Utility Holding Company Act of 1935 or otherwise.
- Factors related to the proposed sale of Point Beach including receipt of the necessary approvals by various regulatory agencies, including the NRC, PSCW, MPSC and FERC for the transaction; and our ability to retain certain assets for the benefit of customers in the decommissioning trusts.
- Factors which impede execution of our PTF strategy, including receipt of necessary state and federal regulatory approvals, timely and successful resolution of legal challenges, local opposition to siting of new generating facilities, construction risks, including the adverse interpretation or enforcement of permit conditions by the permitting agencies, and obtaining the investment capital from outside sources necessary to implement the strategy.
- 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.
- Changes in social attitudes regarding the utility and power industries.
- Customer business conditions including demand for their products or services and supply of labor and material used in creating their products and services.
- The cost and other effects of legal and administrative proceedings, settlements, investigations and claims and changes in those matters.
- Factors affecting the availability or cost of capital such as: changes in interest rates and other general capital market conditions; our capitalization structure; market perceptions of the utility industry, us or any of our subsidiaries; or security ratings.
- Federal, state or local legislative factors such as changes in tax laws or rates; changes in trade, monetary and fiscal policies, laws and regulations; electric and gas industry restructuring initiatives; changes in the Price-Anderson Act; changes in environmental laws and regulations; or changes in allocation of energy assistance, including state public benefits funds.
- Implementation of the Energy Policy Act of 2005 and the effect of state level proceedings and the development of regulations by federal and other agencies, including FERC.
- Authoritative GAAP or policy changes from such standard setting bodies as the FASB, the SEC and the Public Company Accounting Oversight Board.
- Unanticipated technological developments that result in competitive disadvantages and create the potential for impairment of existing assets.

- Possible risks associated with non-utility operations and investments, such as: general economic conditions; competition; operating risks; dependence upon certain suppliers and customers; the cyclical nature of property values that could affect real estate investments; unanticipated changes in environmental or energy regulations; and risks associated with minority investments, where there is a limited ability to control the development, management or operation of the project.

- 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 our Annual Report on Form 10-K for the year ended December 31, 2006.

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



## 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, Wisconsin Gas and 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 metro Milwaukee, Wisconsin; Wisconsin Gas, which serves gas customers in Wisconsin and water customers in suburban Milwaukee, Wisconsin; and Edison Sault, which serves electric customers in the Upper Peninsula of Michigan. Wisconsin Electric and Wisconsin Gas operate under the trade name of "We Energies".

Proposed Sale of Point Beach:

In December 2006, we announced that Wisconsin Electric had signed a definitive agreement with an affiliate of FPL to sell Point Beach for approximately $998 million, subject to closing price adjustments. See Note 4 -- Proposed Sale of Point Beach in the Notes to Consolidated Condensed Financial Statements in this report.

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 2006 Annual Report on Form 10-K for more information on PTF.

Other:

Our other non-utility operating subsidiaries include Wispark, which has approximately $54.1 million of assets and develops and invests in real estate.

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 2006 Annual Report on Form 10-K, including the financial statements and notes therein.



PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WISCONSIN ENERGY CORPORATION

CONSOLIDATED CONDENSED INCOME STATEMENTS

(Unaudited)

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Millions of Dollars, Except Per Share Amounts) | | | |
| Operating Revenues | $906.5 | $814.4 | $2,207.6 | $2,061.4 |
| Operating Expenses | | | | |
| Fuel and purchased power | 232.3 | 184.8 | 461.8 | 354.0 |
| Cost of gas sold | 158.6 | 129.6 | 632.4 | 610.0 |
| Other operation and maintenance | 304.2 | 290.1 | 607.2 | 588.0 |
| Depreciation, decommissioning and amortization | 81.2 | 78.8 | 165.3 | 161.4 |
| Property and revenue taxes | 25.1 | 24.0 | 51.3 | 49.3 |
| Total Operating Expenses | 801.4 | 707.3 | 1,918.0 | 1,762.7 |
| Operating Income | 105.1 | 107.1 | 289.6 | 298.7 |

| | | | | |
|---|---|---|---|---|
| Equity in Earnings of Transmission Affiliate | 10.5 | 9.4 | 21.2 | 19.0 |
| Other Income, Net | 19.8 | 18.3 | 33.0 | 29.6 |
| Interest Expense | 42.0 | 42.6 | 84.7 | 87.8 |
| Income From Continuing | | | | |
| Operations Before Income Taxes | 93.4 | 92.2 | 259.1 | 259.5 |
| Income Taxes | 35.7 | 32.5 | 100.3 | 95.4 |
| Income from Continuing Operations | 57.7 | 59.7 | 158.8 | 164.1 |
| Income (Loss) from Discontinued | | | | |
| Operations, Net of Tax | (0.2) | 3.2 | (0.4) | 4.5 |
| Net Income | $57.5 | $62.9 | $158.4 | $168.6 |
| Earnings Per Share (Basic) | | | | |
| Continuing operations | $0.49 | $0.51 | $1.35 | $1.40 |
| Discontinued operations | - | 0.03 | - | 0.04 |
| Total Earnings Per Share (Basic) | $0.49 | $0.54 | $1.35 | $1.44 |
| Earnings Per Share (Diluted) | | | | |
| Continuing operations | $0.49 | $0.50 | $1.34 | $1.38 |
| Discontinued operations | - | 0.03 | - | 0.04 |
| Total Earnings Per Share (Diluted) | $0.49 | $0.53 | $1.34 | $1.42 |
| Weighted Average Common | | | | |
| Shares Outstanding (Millions) | | | | |
| Basic | 116.9 | 117.0 | 117.0 | 117.0 |
| Diluted | 118.5 | 118.4 | 118.6 | 118.4 |
| Dividends Per Share of Common Stock | $0.25 | $0.23 | $0.50 | $0.46 |

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



WISCONSIN ENERGY CORPORATION

CONSOLIDATED CONDENSED BALANCE SHEETS

| | (Unaudited) June 30, 2007 | December 31, 2006 |
|---|---|---|
| | (Millions of Dollars) | |
| **Assets** | | |
| Property, Plant and Equipment | | |
| In service | $ 9,413.3 | $ 9,265.4 |
| Accumulated depreciation | (3,490.9) | (3,423.7) |
| | 5,922.4 | 5,841.7 |
| Construction work in progress | 1,360.0 | 992.4 |
| Leased facilities, net | 84.7 | 87.5 |
| Nuclear fuel, net | 119.5 | 130.9 |
| Net Property, Plant and Equipment | 7,486.6 | 7,052.5 |
| Investments | | |
| Nuclear decommissioning trust fund | 929.1 | 881.6 |
| Equity investment in transmission affiliate | 234.0 | 228.5 |
| Other | 43.6 | 54.7 |
| Total Investments | 1,206.7 | 1,164.8 |
| Current Assets | | |
| Cash and cash equivalents | 36.7 | 37.0 |
| Accounts receivable | 364.2 | 379.3 |
| Accrued revenues | 161.0 | 257.8 |
| Materials, supplies and inventories | 333.7 | 417.2 |
| Prepayments and Other | 166.2 | 136.7 |
| Total Current Assets | 1,061.8 | 1,228.0 |
| Deferred Charges and Other Assets | | |
| Regulatory assets | 1,106.2 | 1,091.0 |
| Goodwill | 441.9 | 441.9 |
| Other | 159.2 | 152.0 |
| Total Deferred Charges and Other Assets | 1,707.3 | 1,684.9 |
| Total Assets | $ 11,462.4 | $ 11,130.2 |
| **Capitalization and Liabilities** | | |
| Capitalization | | |
| Common equity | $ 2,978.6 | $ 2,889.0 |
| Preferred stock of subsidiary | 30.4 | 30.4 |
| Long-term debt | 3,544.1 | 3,073.4 |
| Total Capitalization | 6,553.1 | 5,992.8 |
| Current Liabilities | | |

| | | |
|---|---|---|
| Long-term debt due currently | 313.4 | 296.7 |
| Short-term debt | 643.7 | 911.9 |
| Accounts payable | 317.1 | 404.5 |
| Accrued liabilities | 129.8 | 161.2 |
| Other | 119.0 | 113.7 |
| Total Current Liabilities | 1,523.0 | 1,888.0 |
| Deferred Credits and Other Liabilities | | |
| Regulatory liabilities | 1,504.4 | 1,472.1 |
| Asset retirement obligations | 380.8 | 371.7 |
| Deferred income taxes - long-term | 555.8 | 572.9 |
| Deferred revenue, net | 256.7 | 186.2 |
| Other | 688.6 | 646.5 |
| Total Deferred Credits and Other Liabilities | 3,386.3 | 3,249.4 |
| Total Capitalization and Liabilities | $ 11,462.4 | $ 11,130.2 |

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)

| | Six Months Ended June 30 | |
|---|---|---|
| | 2007 | 2006 |
| | (Millions of Dollars) | |
| Operating Activities | | |
| Net income | $ 158.4 | $ 168.6 |
| Reconciliation to cash | | |
| Depreciation, decommissioning and amortization | 170.2 | 166.0 |
| Nuclear fuel expense amortization | 14.6 | 14.7 |
| Equity in earnings of transmission affiliate | (21.2) | (19.0) |
| Distributions from transmission affiliate | 15.8 | 14.9 |
| Deferred income taxes and investment tax credits, net | (23.6) | (25.5) |

| | | | |
|---|---|---|---|
| Deferred revenue | | 71.9 | 30.9 |
| Change in - | Accounts receivable and accrued revenues | 111.9 | 219.6 |
| | Inventories | 83.5 | 108.7 |
| | Other current assets | 2.4 | (22.4) |
| | Accounts payable | (74.8) | (156.7) |
| | Accrued income taxes, net | (28.1) | 82.6 |
| | Deferred costs, net | (38.9) | (21.5) |
| | Other current liabilities and Other | 13.5 | 19.7 |
| Cash Provided by Operating Activities | | 455.6 | 580.6 |
| Investing Activities | | | |
| Capital expenditures | | (572.5) | (420.9) |
| Proceeds from asset sales, net | | 16.0 | 41.5 |
| Nuclear fuel | | (3.1) | (16.0) |
| Nuclear decommissioning funding | | (8.8) | (8.8) |
| Proceeds from investments within nuclear decommissioning trust | | 213.4 | 301.7 |
| Purchases of investments within nuclear decommissioning trust | | (213.4) | (301.7) |
| Other | | (28.4) | 2.7 |
| Cash (Used in) Investing Activities | | (596.8) | (401.5) |
| Financing Activities | | | |
| Exercise of stock options | | 30.0 | 7.6 |
| Purchase of common stock | | (54.7) | (13.1) |
| Dividends paid on common stock | | (58.5) | (53.8) |
| Issuance of long-term debt | | 523.4 | - |
| Retirement of long-term debt | | (30.6) | (277.3) |
| Change in short-term debt | | (268.2) | 101.0 |
| Other, net | | (0.5) | 1.4 |
| Cash Provided by (Used in) Financing Activities | | 140.9 | (234.2) |
| Change in Cash and Cash Equivalents | | (0.3) | (55.1) |
| Cash and Cash Equivalents at Beginning of Period | | 37.0 | 73.2 |
| Cash and Cash Equivalents at End of Period | | $ 36.7 | $ 18.1 |
| Supplemental Information - Cash Paid For | | | |
| Interest (net of amount capitalized) | | $ 93.5 | $ 94.9 |
| Income taxes (net of refunds) | | $ 142.0 | $ 46.3 |

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 2006 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 six months ended June 30, 2007 are not necessarily indicative of the results which may be expected for the entire fiscal year 2007 because of seasonal and other factors.

Modifications to Prior Statements:

We have modified certain income statement, balance sheet and cash flows presentations. Prior year financial statement amounts have been reclassified to conform to their current year presentation. These reporting changes had no impact on total earnings per share, total assets or cash provided, or used in operating, investing or financing activities.

2 -- NEW ACCOUNTING PRONOUNCEMENTS

Uncertainty in Income Taxes:

In July 2006, the FASB issued FIN 48, an interpretation of SFAS 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the enterprise's financial statements in accordance with SFAS 109. As of January 1, 2007, the adoption date for FIN 48, the amount of unrecognized tax benefits was approximately $41.7 million, which included estimated accrued interest and penalties of $5.4 million. The amount of unrecognized tax benefits excludes offsetting FIN 48 related deferred tax assets of $12.5 million. We recognize accrued interest and penalties in the provision for income taxes. The impact of adopting FIN 48 was not material. As of the date of adoption, the net amount of the unrecognized tax benefits that, if recognized, would impact the effective tax rate for continuing operations was approximately $10.5 million. During the quarter we resolved approximately $2.9 million of liabilities with state tax jurisdictions of which $1.3 million related to discontinued operations. 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 2006 are subject to federal examination and the tax years of 2002 through 2006 are subject to examination by the State of Wisconsin.

Fair Value Measurements:

In September 2006, the FASB issued SFAS 157. SFAS 157 provides guidance for using fair value to measure assets and liabilities and also defines fair value, provides a framework for measuring fair value and expands disclosures related to fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the provisions of SFAS 157, and we expect to adopt it on January 1, 2008.

Fair Value Option

**:** In February 2007, the FASB issued SFAS 159. SFAS 159 permits an entity to measure certain financial assets and financial liabilities at fair value and also establishes presentation and disclosure requirements. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. We are currently evaluating the provisions of SFAS 159, and we expect to adopt it on January 1, 2008.



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

Background:

As part of our PTF strategy, our non-utility subsidiary, We Power, is building four new generating units (PWGS 1 and 2 and OC 1 and 2) that will be leased to our utility subsidiary, Wisconsin Electric; under long-term leases that have been approved by the PSCW, our primary regulator. The leases are designed to recover the capital costs of the plant including a return. PWGS 1 was placed in service in July 2005 and is being leased to Wisconsin Electric. Wisconsin Electric will be responsible for all of the operating costs, including fuel, of the PTF units once they are placed in service and we anticipate that we will recover the operating costs of these plants in rates. 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.

During Construction:

Under the terms of the lease, we collect in current rates amounts representing our pre-tax cost of capital (debt and equity) associated with capital expenditures for the 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 they will be amortized to revenue when the related assets are placed into service. During the construction of the PTF units, we capitalize interest costs at an overall weighted-average pre-tax cost of interest of approximately 6%. Capitalized interest is included in the total cost of the PTF units.

Cash Flows:

The following table identifies key pre-tax cash outflows and inflows for the six months ended June 30, 2007 and 2006 related to the construction of our PTF units as compared to Wisconsin Energy overall.

| Capital Expenditures (Millions of Dollars) | | | | Total | |
|---|---|---|---|---|---|
| PWGS 1 | PWGS 2 | OC 1 | OC 2 | PTF | WEC |

| | | | | | | |
|---|---|---|---|---|---|---|
| 2007 | $ - | $48.2 | $231.1 | $71.1 | $350.4 | $572.5 |
| 2006 | $ - | $69.5 | $106.4 | $31.2 | $207.1 | $420.9 |

| | Capitalized Interest (Millions of Dollars) | | | | Total | |
|---|---|---|---|---|---|---|
| | PWGS 1 | PWGS 2 | OC 1 | OC 2 | PTF | WEC |
| 2007 | $ - | $6.9 | $18.2 | $5.7 | $30.8 | $31.6 |
| 2006 | $ - | $3.1 | $7.5 | $2.7 | $13.3 | $16.1 |

| | Deferred Revenue, net (Millions of Dollars) | | | | Total | |
|---|---|---|---|---|---|---|
| | PWGS 1 | PWGS 2 | OC 1 | OC 2 | PTF | WEC |
| 2007 | $ - | $15.7 | $42.5 | $13.7 | $71.9 | $71.9 |
| 2006 | $ - | $7.1 | $17.4 | $6.4 | $30.9 | $30.9 |

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 (approximately 14%). The carrying costs are recorded as deferred revenue. 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 June 30, 2007 and December 31, 2006:



| | CWIP - Cash Expenditures (Millions of Dollars) | | | | Total |
|---|---|---|---|---|---|
| | PWGS 1 | PWGS 2 | OC 1 | OC 2 | PTF |
| June 30, 2007 | $ - | $237.1 | $710.0 | $227.7 | $1,174.8 |
| December 31, 2006 | $ - | $196.2 | $487.7 | $152.6 | $836.5 |

| | Total CWIP (Millions of Dollars) | | | | Total | |
|---|---|---|---|---|---|---|
| | PWGS 1 | PWGS 2 | OC 1 | OC 2 | PTF | WEC |
| June 30, 2007 | $ - | $255.6 | $757.8 | $244.3 | $1,257.7 | $1,360.0 |
| December 31, 2006 | $ - | $207.7 | $517.3 | $163.5 | $888.5 | $992.4 |

| | Net Plant in Service (Millions of Dollars) | | | | Total | |
|---|---|---|---|---|---|---|
| | PWGS 1 | PWGS 2 | OC 1 | OC 2 | PTF | WEC |

| | | | | | | |
|---|---|---|---|---|---|---|
| June 30, 2007 | $346.9 | $ - | $ - | $ - | $346.9 | $5,922.4 |
| December 31, 2006 | $350.1 | $ - | $ - | $ - | $350.1 | $5,841.7 |

| | Deferred Revenue (Millions of Dollars) | | | | Total | |
|---|---|---|---|---|---|---|
| | PWGS 1 | PWGS 2 | OC 1 | OC 2 | PTF | WEC |
| June 30, 2007 | $67.0 | $43.2 | $108.4 | $38.1 | $256.7 | $256.7 |
| December 31, 2006 | $68.3 | $27.5 | $66.0 | $24.4 | $186.2 | $186.2 |

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. The authorized cash costs are established by the PSCW. The authorized cash costs exclude capitalized interest because 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 establish 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 will include the amortization of the deferred revenues that reflect the carrying costs that are collected during construction. The deferred revenue will be amortized on a straight line basis over the lease term. We will depreciate the units on a straight line basis over their expected service life.

In July 2005, PWGS 1 was placed in service. This asset had a cost of approximately $364.3 million which included approximately $31.1 million of capitalized interest. The asset is being depreciated over its estimated useful life of approximately 37 years. The cost of the plant, plus a return, is expected to be recovered through Wisconsin Electric's rates over a 25 year period at an annual amount of approximately $48 million.

4 -- PROPOSED SALE OF POINT BEACH

In December 2006, we announced that we had signed a definitive agreement with an affiliate of FPL to sell Point Beach for approximately $998 million, subject to closing price adjustments. We also entered into a long-term power purchase agreement to purchase all of the existing capacity and energy of the plant. This long-term power purchase agreement will become effective upon the closing of the sale. The sale of the plant and the long-term power purchase agreement are subject to review and approval by various regulatory agencies, including the NRC, PSCW, MPSC and FERC. As of June 30, 2007, we have received approval from FERC. We anticipate closing the sale during the third quarter of 2007.

Under the terms of the asset sale agreement, the buyer is to assume the obligation to decommission the plant, and we will transfer certain decommissioning funds to the buyer. The total amount of funds that are to be transferred to the buyer are subject to approval by the PSCW.

We expect that the gain from the proposed sale and any decommissioning funds retained by the Company, less transaction related costs, will be credited to our customers as determined by the various regulatory authorities in rate proceedings.

**5 -- 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 2006 Annual Report on Form 10-K. Effective January 1, 2006, we adopted SFAS 123R using the modified prospective method. We utilize the straight-line attribution method for recognizing share-based compensation expense under SFAS 123R. 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 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 June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Millions of Dollars) | | | |
| Stock options | $2.5 | $1.9 | $7.2 | $3.8 |
| Performance units | 1.3 | 1.1 | 1.4 | 2.7 |
| Restricted stock | 0.2 | 0.3 | 0.5 | 0.6 |
| Share-based compensation expense | $4.0 | $3.3 | $9.1 | $7.1 |
| Related Tax Benefit | $1.7 | $1.3 | $3.7 | $2.8 |

Stock Option Activity:

During the first six months of 2007, the Compensation Committee granted 1,371,590 options that had an estimated fair value of $8.72 per share. During the first six months of 2006, the Compensation Committee granted 1,292,275 options that had an estimated fair value of $7.55 per share. The following assumptions were used to value the options using a binomial option pricing model:

| | 2007 | 2006 |
|---|---|---|
| Risk free interest rate | 4.7% - 5.1% | 4.3% - 4.4% |
| Dividend yield | 2.2% | 2.4% |
| Expected volatility | 13.0% - 20.0% | 17.0% - 20.0% |
| Expected forfeiture rate | 2.0% | 2.0% |
| Expected life (years) | 6.0 | 6.3 |

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 through the three and six months ended June 30, 2007.

| Stock Options | Number of Options | Weighted - Average Exercise Price | Weighted-Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value (Millions) |
|---|---|---|---|---|
| Outstanding as of April 1, 2007 | 8,287,815 | $33.69 | | |
| Granted | - | | | |
| Exercised | (342,383) | $27.12 | | |
| Forfeited | - | | | |
| Outstanding as of June 30, 2007 | 7,945,432 | $33.98 | | |
| Outstanding as of January 1, 2007 | 7,721,826 | $30.52 | | |
| Granted | 1,371,590 | $47.76 | | |
| Exercised | (1,137,020) | $27.10 | | |
| Forfeited | (10,964) | $35.66 | | |
| Outstanding as of June 30, 2007 | 7,945,432 | $33.98 | 6.8 | $81.5 |

| | | | | |
|---|---|---|---|---|
| Exercisable as of June 30, 2007 | 4,471,152 | $28.82 | 5.5 | $68.9 |

The intrinsic value of options exercised was $7.5 million and $24.2 million for the three and six months ended June 30, 2007, and $1.1 million and $5.6 million for the same periods in 2006, respectively. Cash received from options exercised was $30.0 million and $7.6 million for the six months ended June 30, 2007 and 2006, respectively. The related tax benefit for the same periods was approximately $8.9 million and $2.2 million, respectively.

The following table summarizes information about our non-vested options during the three and six months ended June 30, 2007:

| Non-Vested Stock Options | Number of Options | Weighted-Average Fair Value |
|---|---|---|
| Non-vested as of April 1, 2007 | 3,584,859 | $8.21 |
| Granted | - | - |
| Vested | (110,579) | $8.19 |
| Forfeited | - | - |
| Non-vested as of June 30, 2007 | 3,474,280 | $8.21 |
| | | |
| Non-vested as of January 1, 2007 | 2,587,849 | $7.94 |
| Granted | 1,371,590 | $8.72 |
| Vested | (477,995) | $8.22 |
| Forfeited | (7,164) | $8.18 |
| Non-vested as of June 30, 2007 | 3,474,280 | $8.21 |

As of June 30, 2007, total compensation costs related to non-vested stock options not yet recognized was approximately $13.1 million, which is expected to be recognized over the next 22 months on a weighted-average basis.



The following table summarizes information about stock options outstanding as of June 30, 2007:

| | Options Outstanding | | | Options Exercisable | | |
|---|---|---|---|---|---|---|
| | | Weighted - Average | | | Weighted - Average | |
| Range of Exercise Prices | Number | Exercise Price | Remaining Contractual Life (Years) | Number | Exercise Price | Remaining Contractual Life (Years) |
| $12.79 to $23.05 | 1,147,141 | $21.49 | 3.9 | 1,147,141 | $21.49 | 3.9 |
| $25.31 to $31.07 | 1,567,082 | $27.04 | 5.1 | 1,567,082 | $27.04 | 5.1 |
| $33.44 to $47.76 | 5,231,209 | $38.80 | 8.0 | 1,756,929 | $35.20 | 6.9 |
| | 7,945,432 | $33.98 | 6.8 | 4,471,152 | $28.82 | 5.5 |

Restricted Shares:

The Compensation Committee has also approved restricted stock grants to certain key employees and directors. The following restricted stock activity occurred during the three and six months ended June 30 2007:

| Restricted Shares | Number of Shares | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Outstanding as of April 1, 2007 | 158,954 | |
| Granted | - | |
| Released / Forfeited | (3,951) | $25.31 |
| Outstanding as of June 30, 2007 | 155,003 | |
| | | |
| Outstanding as of January 1, 2007 | 184,665 | |
| Granted | 14,139 | $47.19 |
| Released / Forfeited | (43,801) | $26.75 |
| Outstanding as of June 30, 2007 | 155,003 | |

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 $0.6 million and $2.5 million for the three and six months ended June 30, 2007, and $0.4 million for the same periods in 2006. The related tax benefit was $0.2 million and $0.9 million for the three and six months ended June 30, 2007 and $0.1 million for the same periods in 2006.

As of June 30, 2007, total compensation cost related to restricted stock not yet recognized was approximately $2.7 million, which is expected to be recognized over the next 50 months on a weighted-average basis.

Performance Units:

In January 2007 and 2006, the Compensation Committee granted 136,905 and 150,821 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. We are accruing compensation costs over the three year period based on our estimate of the final expected value of the award. Performance units vesting were approximately $0.9 million, with a related tax benefit of $0.3 million, during the six months ended June 30, 2007. Performance shares earned as of December 31, 2006, vested and were distributed during the first quarter of 2007 and had a total intrinsic value of $7.2 million. The tax benefit realized due to the distribution of performance shares was approximately $2.1 million. As of June 30, 2007, total compensation cost related to performance units



not yet recognized was approximately $7.8 million, which is expected to be recognized over the next 24 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 our principal utility subsidiaries, Wisconsin Electric and Wisconsin Gas. Various financing arrangements and regulatory requirements impose certain restrictions on the ability of our principal utility 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 2006 Annual Report on Form 10-K for additional information on these restrictions.

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.

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. We recorded the following total comprehensive income during the six months ended June 30:

| Comprehensive Income | 2007 | 2006 |
|---|---|---|
| | (Millions of Dollars) | |
| Net Income | $158.4 | $168.6 |
| Other Comprehensive Income | | |
| Hedging | 0.2 | 0.2 |
| Total Other Comprehensive Income | 0.2 | 0.2 |

| | | |
|---|---|---|
| Total Comprehensive Income | $158.6 | $168.8 |

6 -- LONG-TERM DEBT

In May 2007, we issued $500 million of the Junior Notes due 2067. Due to certain features of the Junior Notes, rating agencies consider them to be hybrid instruments with a combination of debt and equity characteristics. 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 fund PTF and for other working capital purposes.

In connection with the issuance of the 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.



7 -- DERIVATIVE INSTRUMENTS

We follow SFAS 133, as amended by SFAS 149, effective July 1, 2003, which requires that every derivative instrument be recorded on the balance sheet as an asset or liability measured at its fair value and that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. For most energy related physical and financial contracts in our regulated operations that qualify as derivatives under SFAS 133, the PSCW allows the effects of the fair market value accounting to be offset to regulatory assets and liabilities. As of June 30, 2007 we recognized $16.5 million in regulatory assets and $2.1 million in regulatory liabilities related to derivatives.

8 -- BENEFITS

The components of our net periodic pension and OPEB costs for the three and six months ended June 30, 2007 and 2006 were as follows:

| | Pension Benefits | | OPEB | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | (Millions of Dollars) | | | |
| Three Months Ended June 30 | | | | |

| | | | | |
|---|---|---|---|---|
| Net Periodic Benefit Cost | | | | |
| Service cost | $7.2 | $7.9 | $2.7 | $2.8 |
| Interest cost | 18.0 | 17.5 | 4.9 | 4.4 |
| Expected return on plan assets | (20.9) | (20.8) | | |

| | | |
|---|---|---|
| | (3.8) | (3.8) |
| Amortization of: | | |
| Transition obligation | - | - |
| | 0.1 | 0.2 |
| Prior service cost (credit) | 1.6 | 1.4 |
| | (3.3) | (3.4) |
| Actuarial loss | | |

4.3

5.6

1.9

2.0

Net Periodic Benefit Cost

$10.2

$11.6

$2.5

$2.2

| <u>Six Months Ended June 30</u> | | | | |
|---|---|---|---|---|
| Net Periodic Benefit Cost | | | | |
| Service cost | $15.1 | $17.0 | $5.8 | $6.2 |
| Interest cost | 35.8 | 34.9 | 9.6 | 9.0 |
| Expected return on plan assets | (42.2) | (41.0) | (7.6) | (7.5) |
| Amortization of: | | | | |
| Transition obligation | - | - | 0.2 | 0.2 |
| Prior service cost (credit) | 2.9 | 2.7 | (6.7) | (6.8) |
| Actuarial loss | 9.0 | 11.7 | 3.7 | 4.4 |
| Net Periodic Benefit Cost | $20.6 | $25.3 | $5.0 | $5.5 |

9 -- GUARANTEES

We enter into various guarantees to provide financial and performance assurance to third parties on behalf of our affiliates. As of June 30, 2007, we had the following guarantees:

| | Maximum Potential Future Payments | Outstanding as of June 30, 2007 | Liability Recorded as of June 30, 2007 |
|---|---|---|---|
| | | (Millions of Dollars) | |
| Wisconsin Energy | | | |
| Non-Utility Energy | $ - | $ - | $ - |
| Other | 2.5 | 2.5 | - |
| Wisconsin Electric | 234.1 | 0.2 | - |
| Subsidiary | 6.2 | 6.2 | 0.9 |
| Total | $242.8 | $8.9 | $0.9 |

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 UI. 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.

Other guarantees 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 guarantees the potential retrospective premiums that could be assessed under Wisconsin Electric's nuclear insurance program (see Note I -- Nuclear Operations in our 2006 Annual Report on Form 10-K).

Subsidiary guarantees support loan obligations and surety bonds between our affiliates and third parties. In the event our affiliates fail to perform, our subsidiary would be responsible for the obligations.

Postemployment benefits:

Postemployment benefits provided to former or inactive employees are recognized when an event occurs. The estimated liability, excluding severance benefits, for such benefits was $12.9 million as of June 30, 2007 and $13.0 million as of December 31, 2006.

10 -- SEGMENT INFORMATION

Summarized financial information concerning our reportable operating segments for the three and six month periods ended June 30, 2007 and 2006 is shown in the following table.

| | Reportable Operating Segments | | Corporate & Other (a) & Reconciling (c) | Total |
|---|---|---|---|---|
| | Energy | | | |
| Wisconsin Energy Corporation | Utility | Non-Utility | Items | Consolidated |
| | (Millions of Dollars) | | | |
| Three Months Ended | | | | |
| June 30, 2007 | | | | |
| Operating Revenues (b) | $903.8 | $21.1 | ($18.4) | $906.5 |
| Operating Income (Loss) | $94.7 | $11.1 | ($0.7) | $105.1 |
| Interest Expense | $28.1 | $1.9 | $12.0 | $42.0 |
| Income Tax Expense (Benefit) | $37.5 | $3.2 | ($5.0) | $35.7 |
| Loss from Discontinued Operations, Net | $ - | $ - | ($0.2) | ($0.2) |
| Net Income (Loss) | $58.1 | $6.0 | ($6.6) | $57.5 |
| Capital Expenditures | $103.0 | $179.3 | $ - | $282.3 |
| Three Months Ended | | | | |
| June 30, 2006 | | | | |
| Operating Revenues (b) | $812.3 | $20.2 | ($18.1) | $814.4 |
| Operating Income (Loss) | $98.6 | $11.5 | ($3.0) | $107.1 |
| Interest Expense | $26.5 | $3.6 | $12.5 | $42.6 |
| Income Tax Expense (Benefit) | $35.6 | $3.7 | ($6.8) | $32.5 |
| Income from Discontinued Operations, Net | $ - | $ - | $3.2 | $3.2 |
| Net Income | $58.0 | $4.6 | $0.3 | $62.9 |
| Capital Expenditures | $97.7 | $108.7 | $ - | $206.4 |

| Wisconsin Energy Corporation | Reportable Operating Segments<br>Energy<br>Utility | <br><br>Non-Utility | Corporate & Other (a) & Reconciling (c)<br>Items | Total<br>Consolidated |
|---|---|---|---|---|
| | (Millions of Dollars) | | | |
| Six Months Ended | | | | |
| June 30, 2007 | | | | |
| Operating Revenues (b) | $2,204.4 | $35.6 | ($32.4) | $2,207.6 |
| Operating Income (Loss) | $272.2 | $20.8 | ($3.4) | $289.6 |
| Interest Expense | $57.2 | $3.8 | $23.7 | $84.7 |
| Income Tax Expense (Benefit) | $103.6 | $6.5 | ($9.8) | $100.3 |
| Loss from Discontinued Operations, Net | $ - | $ - | ($0.4) | ($0.4) |
| Net Income (Loss) | $161.3 | $10.6 | ($13.5) | $158.4 |
| Capital Expenditures | $217.3 | $353.4 | $1.8 | $572.5 |
| Total Assets | $10,119.1 | $1,627.8 | ($284.5) | $11,462.4 |
| Six Months Ended | | | | |
| June 30, 2006 | | | | |
| Operating Revenues (b) | $2,059.5 | $34.4 | ($32.5) | $2,061.4 |
| Operating Income (Loss) | $284.1 | $20.6 | ($6.0) | $298.7 |
| Interest Expense | $54.6 | $7.9 | $25.3 | $87.8 |
| Income Tax Expense (Benefit) | $103.0 | $5.8 | ($13.4) | $95.4 |
| Income from Discontinued Operations, Net | $ - | $ - | $4.5 | $4.5 |
| Net Income (Loss) | $169.2 | $7.2 | ($7.8) | $168.6 |
| Capital Expenditures | $213.1 | $207.8 | $ - | $420.9 |
| Total Assets | $9,415.2 | $992.2 | ($7.0) | $10,400.4 |

(a) Other includes all other non-utility activities, primarily non-utility real estate investment and development by Wispark and non-utility investment in renewable energy and recycling technology by Minergy, as well as interest on corporate debt.

(b) An elimination for intersegment revenues is included in Operating Revenues of $19.5 million and $18.6 million for the three months ended June 30, 2007 and 2006, respectively, and in the amounts of $34.2 million and $33.1 million for the six months ended June 30, 2007 and 2006, respectively.

(c) An elimination for the PWGS 1 lease between We Power and Wisconsin Electric is included in Total Assets of $310.9 million and $322.6 million at June 30, 2007 and 2006, respectively.

11 -- COMMITMENTS AND CONTINGENCIES

Environmental Matters:

We periodically review our exposure for remediation costs as evidence becomes available indicating that our remediation liability has changed. Based on 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. 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. We have established reserves as deemed appropriate for these indemnification provisions.



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

RESULTS OF OPERATIONS -- THREE MONTHS ENDED JUNE 30, 2007

CONSOLIDATED EARNINGS

The following table compares our net income during the second quarter of 2007 with the second quarter of 2006 including favorable (better (B)) or unfavorable (worse (W)) variances.

| | Three Months Ended June 30 | | |
|---|---|---|---|
| | 2007 | B (W) | 2006 |

| | (Millions of Dollars) | | |
|---|---|---|---|
| Utility Energy Segment | $94.7 | ($3.9) | $98.6 |
| Non-Utility Energy Segment | 11.1 | (0.4) | 11.5 |
| Corporate and Other | (0.7) | 2.3 | (3.0) |
| Total Operating Income | 105.1 | (2.0) | 107.1 |
| Equity in Earnings of Transmission Affiliate | 10.5 | 1.1 | 9.4 |
| Other Income, net | 19.8 | 1.5 | 18.3 |
| Interest Expense | 42.0 | 0.6 | 42.6 |
| Income From Continuing Operations Before Income Taxes | 93.4 | 1.2 | 92.2 |
| Income Taxes | 35.7 | (3.2) | 32.5 |
| Income From Continuing Operations | 57.7 | (2.0) | 59.7 |
| Income (Loss) From Discontinued Operations, Net of Tax | (0.2) | (3.4) | 3.2 |
| Net Income | $57.5 | ($5.4) | $62.9 |
| Diluted Earnings Per Share | | | |
| | $0.49 | ($0.01) | |
| Continuing Operations | | | $0.50 |
| Discontinued Operations | $ - | ($0.03) | $0.03 |
| Total Diluted Earnings Per Share | $0.49 | ($0.04) | $0.53 |

UTILITY ENERGY SEGMENT CONTRIBUTION TO OPERATING INCOME

Our utility energy segment contributed $94.7 million of operating income during the second quarter of 2007, a decrease of $3.9 million or 4.0% compared with the second quarter of 2006. The following table summarizes the operating income of this segment between the comparative quarters.

| Utility Energy Segment | Three Months Ended June 30 | | |
|---|---|---|---|
| | 2007 | B (W) | 2006 |
| | (Millions of Dollars) | | |
| Operating Revenues | | | |
| Electric | $662.4 | $60.5 | $601.9 |
| Gas | 233.6 | 29.5 | 204.1 |
| Other | 7.8 | 1.5 | 6.3 |
| Total Operating Revenues | 903.8 | 91.5 | 812.3 |
| Fuel and Purchased Power | 233.3 | (47.5) | 185.8 |
| Cost of Gas Sold | 158.6 | (29.0) | 129.6 |
| Gross Margin | 511.9 | 15.0 | 496.9 |
| Other Operating Expenses | | | |
| Other Operation and Maintenance | 313.9 | (15.1) | 298.8 |
| Depreciation, Decommissioning and Amortization | 78.1 | (2.4) | 75.7 |
| Property and Revenue Taxes | 25.2 | (1.4) | 23.8 |
| Operating Income | $94.7 | ($3.9) | $98.6 |

Electric Utility Revenues and Sales

The following table compares electric utility operating revenues and MWh sales by customer class during the second quarter of 2007 with the second quarter of 2006.

| | Three Months Ended June 30 | | | | | |
|---|---|---|---|---|---|---|
| | Electric Revenues | | | MWh Sales | | |
| | 2007 | B (W) | 2006 | 2007 | B (W) | 2006 |
| | (Millions of Dollars) | | | (Thousands) | | |
| Customer Class | | | | | | |
| Residential | $214.4 | $21.9 | $192.4 | 1,960.8 | 114.9 | 1,845.9 |
| Small Commercial/Industrial | 213.2 | 19.5 | 193.7 | 2,292.1 | 76.7 | 2,215.4 |
| Large Commercial/Industrial | 182.2 | 20.3 | 161.9 | 2,853.8 | 25.4 | 2,828.4 |
| Other Retail | 4.6 | 0.3 | 4.3 | 39.9 | 1.2 | 38.7 |