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Public Service Commission of Wisconsin
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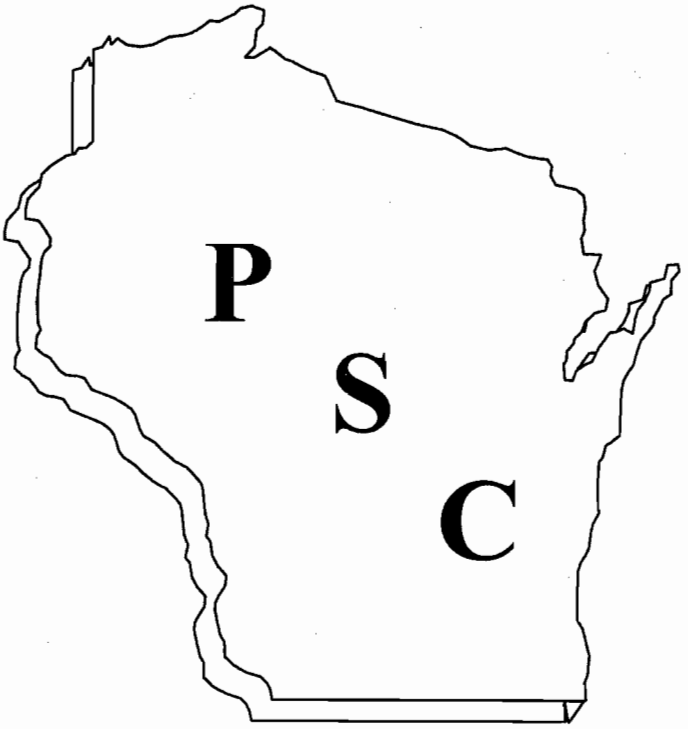
Audit Report on WPS Resources Corporation 2002-2005



Public Service Commission of Wisconsin

Approved by Commission:

Public Service Commission of Wisconsin

Daniel R. Ebert, Chairperson
Robert M. Garvin, Commissioner
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610 North Whitney Way
P.O. Box 7854
Madison, WI 53707-7854

December 11, 2006

Mr. Robert J Marchant, Senate Chief Clerk
P.O. Box 7882
Madison, WI 53707-7882

Mr. Patrick E. Fuller, Assembly Chief Clerk
P.O. Box 7882
Madison, WI 53707-7882

Re: Wisconsin Public Service Commission Audit Report to the Legislature on the Operations of WPS Resources Corporation — File 9405

Dear Mr. Marchant and Mr. Fuller:

The enclosed audit report on WPS Resources Corporation (WPSR) and its impact on the operations of Wisconsin Public Service Corporation (WPSC) was prepared as required by Wis. Stat. § 196.795(7)(ar) for distribution to the Wisconsin Legislature under Wis. Stat. § 13.172(2).

On July 10, 2006, WPSR and Peoples Energy Corporation announced the signing of a definitive merger agreement that will create a diversified energy company with regulated utilities serving four Midwest states and non-regulated businesses serving customers in the Northeast U.S. and Canada. On August 9, 2006, the Commission opened an investigation pursuant to Wis. Stat. § 196.02(7) to consider any and all effects of the merger, combination, and reorganization on the existing holding company, WPSR, and its subsidiaries, specifically WPSC including but not limited to jurisdictional and approval authority.

If you have any questions or comments about the report, please contact Ms. Diane Braun of the Commission Staff at (608) 267-1200.

Sincerely,

Sandra J. Paske
Secretary to the Commission

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Enclosure

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WPS RESOURCES CORPORATION

PUBLIC SERVICE COMMISSION OF WISCONSIN

REPORT TO THE LEGISLATURE

Introduction

In November 1985, the Wisconsin Legislature enacted 1985 Wisconsin Act 79 (Act 79). This act approved the formation of holding companies by non-telecommunication public utilities and created Wis. Stat. § 196.795.

Wis. Stat. § 196.795(7)(ar) provides that three years after the formation of a holding company under this section, the Commission shall, as a result of its investigation, report its findings to the legislature. Thereafter, at least once every two years, the Commission shall report on the impact of the holding company, including the benefits and adverse effects on every public utility affiliate in the holding company system and on the investors and consumers of such public utility affiliates. The report shall include any recommendations for legislation relating to the regulation of any part of a holding company system.

The Commission approved the formation of WPS Resources Corporation (WPSR) as a holding company on June 1, 1994, in docket 9405-YO-100. The holding company structure became effective September 9, 1994. Wisconsin Public Service Corporation (WPSC), the predominant subsidiary of WPSR, is a Wisconsin corporation engaged in rendering electric and gas utility service to the public and is a public utility as defined in Wis. Stat. § 196.01.

The following report is in accordance with Wis. Stat. § 196.795(7)(ar). The report discusses the impact of WPSR on WPSC and WPSC's investors and customers, as well as the nature of the business of each non-utility affiliate. A recommendation for legislation relating to the regulation of holding company systems is also discussed.

The time period covered by the financial section of this report is from 2002 through 2005. The audit findings discussed in Appendix A are based primarily on 2002-2004 transactions.

Impact on Public Utilities

Section 1(7) of Act 79 provides that the public interest and the interest of investors and consumers can be protected if:

> (a) Transactions between a public utility in a public utility holding company system and the holding company or its non-utility affiliates are subject to public service commission approval and regulation to assure that reasonable prices are charged and costs properly allocated.

(b) The non-utility activities of the public utility holding company system do not substantially lessen competition, do not tend to create a monopoly or restrain trade, and do not constitute an unfair business practice.

(c) The public utility activities of a non-telecommunications public utility in a public utility holding company system remain subject to Public Service Commission (PSC) jurisdiction and regulation.

(d) The activities of the public utility holding company system do not cause any materially detrimental effect on the public utility's rates for or reliability of utility service to the public, cost of capital or ability to raise capital.

(e) The PSC has access to the books and records of the public utility holding company system to the extent relevant for the Commission to regulate any public utility in the system.

(f) The provision of reliable and reasonably priced public utility service remains the predominant business of a public utility holding company system.

Wis. Stat. § 196.795(5)(g) further provides that:

> No holding company system may be operated in any way which materially impairs the credit, ability to acquire capital on reasonable terms or ability to provide safe, reasonable, reliable and adequate utility service of any public utility affiliate in the holding company system.

The audit report included as Appendix A to this report discusses Commission staff's audit findings and recommendations regarding § 1(7)(a) of Act 79. Regarding § 1(7)(c) of Act 79, Wis. Stat. § 196.795(5)(j) provides that WPSC is subject to every law, regulation, and precedent applicable to the regulation of public utilities. Regarding § 1(7)(e) of Act 79, this provision is addressed by Wis. Stat. § 196.795(5)(b) and to the extent applicable, in the audit report included as Appendix A.

The following discussion summarizes the impact WPSR has had on its public utility affiliate and on the investors and consumers of the public utility affiliate as set forth in §§ 1 (7)(b), (d), and (f) of Act 79. The discussion includes the size of non-utility business, financial impact, impact on utility rates and reliability of service, and impact on competition. Since all of the major utilities in Wisconsin are now in holding company systems, and most have been for many years, comparisons between utilities or between periods before and after becoming a holding company are no longer beneficial in determining the holding company's impact on the utility.

A. Size of Non-utility Business

Section 1(7)(f) of Act 79 provides that, the provision of reasonably priced and reliable public utility service shall be the predominant business of a public utility holding company system. Wis. Stat. § 196.795(5)(p), therefore, restricts the sum of the assets of all non-utility affiliates to the sum of 25 percent of the electric utility assets and 25 percent or more of the assets used to

provide other utility services (i.e., natural gas, steam, and water). In its 1994 order,[1] which approved the formation of WPSR, the Commission set the aggregate level of non-utility assets at 25 percent for the assets of WPSC. This asset limitation remains in effect.

1999 Wisconsin Act 9 (Act 9) created Wis. Stat. § 196.795(6m)(e) in October 1999. Wis. Stat. § 196.795(6m)(e) provides a public utility holding company partial relief from limits on non-utility assets it may own if the electric utilities in the holding company system transfer their electric transmission facilities to a separate transmission company under Wis. Stat. § 196.485(5)(b).

Effective January 1, 2001,[2] WPSC transferred its electric transmission system assets to American Transmission Company LLC (ATC) in exchange for an equity interest in the new company. As a result of the transfer of these assets, WPSR meets the criteria for the partial relief provided under Wis. Stat. § 196.795(6m)(e) from the limits on non-utility assets pursuant to Wis. Stat. § 196.485(5)(b).

As of December 31, 2005, more than 11 years after the holding company was formed, total non-utility assets of WPSR, excluding "eligible assets" pursuant to Wis. Stat. § 196.795(6m)(e), equaled .63 percent of total combined utility assets. On that date, 25 percent of total combined utility assets amounted to $695.5 million. Total non-utility assets as of the end of 2005 were $17.5 million, after excluding eligible assets, as shown in Table 1.

Table 1

WPS Resources Corporation
Utility and Non-utility Assets

	2000-2005 ($1,000)					
	2005	2004	2003	2002	2001	2000
A. Utility assets	2,782,087	2,849,942	2,651,138	1,976,080	1,833,511	1,637,091
B. Non-utility assets (1)	17,547	81,515	106,320	32,460	38,856	18,408
C. Consolidated	2,799,634	2,931,457	2,757,458	2,008,540	1,872,367	1,655,499
D. Investment percent (Line B / Line A)	.63%	2.86%	4.01%	1.64%	2.12%	1.12%
E. 25% of total combined utility assets	695,522	712,486	662,785	494,020	458,378	409,273

(1)Excluding eligible assets under Wis. Stat. § 196.795(6m).

[1] Docket 9405-YO-100 dated June 1, 1994.

[2] WPSC made an unconditional, irrevocable, and binding commitment to transfer its transmission assets to the transmission company to be formed under Wis. Stat. § 196.485(5)(a) on October 23, 2000. WPSC joined the Midwest Independent Transmission System Operator (MISO) on January 1, 2001.

B. Financial

As stated previously, Wis. Stat. § 197.795(5)(g) provides that no holding company system may be operated in any way which materially impairs the credit or ability to acquire capital on reasonable terms of any public utility affiliate in the holding company system.

1. Current Restriction and Findings

Assessing the reasonableness of WPSC's capital structure depends upon three important principles. First, capital structure decisions must be based on WPSC's needs, not on the needs of the non-utility operations of the holding company. Second, the capital structure should provide adequate flexibility to WPSC and to the Commission to allow proper utility investment now and in the future. Third, the dividend policy of WPSC should be similar to typical electric utility dividend practices as long as WPSC is below the estimated test year common equity ratio.

The utility needs must take precedence over non-utility needs if ratepayers are to be protected. Wis. Stat. § 196.795 requires the Commission to protect ratepayers from utilities that grant a higher priority to non-utility needs. The identification of utility needs goes beyond foreseeable needs. WPSC must have flexibility to finance both foreseen and unforeseen capital requirements.

In previous rate case dockets, the Commission recognized the need to protect ratepayers and to ensure that utility needs are placed before non-utility needs in capital structure and dividend policy choices. As of December 31, 2005, a reasonable capital structure for WPSC was 50 to 55 percent common equity on a financial basis.[3] In docket 6690-UR-117, the Commission reaffirmed that WPSC shall not pay, without Commission approval, normal dividends greater than 109 percent of the prior year's common dividend. In addition, WPSC shall notify the Commission if any special dividend is contemplated. No special dividend that might cause the common equity, on a financial basis as calculated in the Commission order in docket 6690-UR-117, to drop below the projected calendar year average of 52.50 percent or the dollar amount of equity reflected in the test year, is permitted without Commission approval. WPSC has maintained a strong financial capital structure since the formation of the holding company. WPSC has reasonably managed its capital structure and dividend policy to be consistent with the intent of the Commission directives.

Listed in Table 2 below, are selected financial statistics for WPSC and WPSR for the period 2000 through 2005.

[3] As established in docket 6690-UR-117, dated December 22, 2005.

Table 2
Selected Financial Statistics

	2000-2005					
	2005	2004	2003	2002	2001	2000
WPSC						
Common equity ratio-year end [1]	52.62%	54.50%	55.29%	61.54%	56.71%	54.24%
Pretax interest coverage [2]	3.47	5.38	4.45	4.50	4.31	4.49
Earned return on equity-regulatory [3]	8.63%	12.61%	10.40%	11.50%	12.38%	13.06%
Earned return on equity-financial [4]	8.73%	12.78%	10.57%	11.71%	12.65%	13.45%
U.S. Treasury bond yields-10 year [5]	4.29%	4.27%	4.01%	4.61%	5.02%	6.03%
WPSR						
Common equity ratio-year end [2]	52.35%	47.31%	49.64%	43.27%	43.45%	37.88%
Pretax interest coverage [2]	2.48	3.75	3.02	3.53	2.68	2.33
Earned return on equity [6]	13.6%	13.5%	11.5%	14.6%	12.8%	12.4%

Sources:
[1] PSCW Annual Reports (includes capital leases but excludes WPS Leasing's debt and goodwill).
[2] Calculated from Form 10-K to the Securities and Exchange Commission using PSCW methodology.
[3] Form PSC-AF 6.
[4] Form PSC-AF 5.
[5] Federal Reserve Statistical Release Website.
[6] WPSR reported in Form 10-K.

2. Credit Ratings

WPSC's current first mortgage bond ratings are A+ by Standard & Poor's (S&P) and Aa2 by Moody's Investor's Service (Moody's). WPSC's preferred stock is rated A- by S&P and A2 by Moody's. According to S&P, as of February 2006, the outlook for WPS Resources was negative because it has multiple events that must be successfully completed before its performance can be considered stable. S&P stated that an outlook revision to stable is unlikely in the near term, since it would require a solid indication that the company's financial position will strengthen and stabilize in the next few years; that the current construction program will remain on time and on budget; and that available liquidity is improving. S&P indicated that ratings could be lowered as a result of unfavorable regulatory actions, or if the company fails to achieve substantial improvement in its financial measures in the next few years.

C. Impact on Competition

As indicated in the prior report there were no complaints filed with the Commission concerning the non-utility activities of WPSC and WPSR from 1996-2001, nor have any official complaints been received for 2002-2005. However, one company did ask the Commission to look into the WPS At Your Service program. Concerns were expressed that the fee to join this program was too high to allow some small companies to participate, and that this network would reduce or eliminate competition.

WPSC exited the gas appliance servicing business on January 1, 2001. To lessen the impact on customers, WPSR created the WPS At Your Service network of contractors as a non-regulated

interim solution. This program provided referral services for repairs and maintenance on central heating, cooling and water heating systems beginning in September 2000. Vendors were recruited by WPSR to join this network, and under the Service Provider Agreement would pay WPS At Your Service a fee based on a percentage of the gross revenue received. On July 9, 2001, WPS At Your Service announced that this interim measure is not needed in the market and that they would be exiting the residential heating, ventilating, and air conditioning repair, replacement, and maintenance business as of July 31, 2001.

D. Utility Rates

Appendix B provides a breakdown of the changes in rates by rate order since 1995. This schedule shows substantial increases in rates since 2000. This is consistent with the trend shown by all major Wisconsin energy utilities during this period.

E. Reliability of Service

Although not reiterated in the WPSR holding company formation order, the Commission has stated in prior holding company orders that it is necessary for the public utility to maintain its investment in utility operations in order to remain a strong, ongoing utility. This is a requirement of its franchise as a regulated monopoly. These utility investments can include, but need not be limited to, new construction of utility plant, utility system maintenance and upgrading, electric line loss reduction, conservation and other environmental considerations such as SO_2/NOx reduction.

In evaluating a utility's commitment to reliability of service, the Commission looks at numerous areas including the volume of service complaints, construction and other costs expended to upgrade the system, and the level of activity in areas such as least cost planning and transmission planning. The following are comments related to the Commission's review of these areas:

1. Complaints

As reported in the prior audit report, complaints received by the Commission in the past related to WPSC have been relatively low. In 1999-2001, the number of complaints averaged 322 per year due mostly to complaints about disconnection and deferred payment agreements.

By 2003, the level of complaints had decreased to below the 1999 level. In 2004 and 2005, the number of billing and credit complaints increased substantially due to increases in complaints about deferred payment agreements, disconnection threats and disconnection for nonpayment.

As shown in Table 3, the service related complaints have been minimal.

Table 3[4]

Year	Number of Billing and Credit Complaints	Number of Service Complaints	Total Complaints
2001	291	39	330
2002	237	34	263
2003	191	28	219
2004	584	36	620
2005	652	27	679

2. Construction Activity

Completed construction expenditures for WPSC (stated in 2005 dollars)[5] averaged approximately $162 million for 1998-2000, which compares to an average of approximately $193 million in 2001-2005.

For 2003 through 2005 the completed construction (non-inflation adjusted) totaled $153 million, $208 million and $177 million respectively. The major projects included $33 million for a 75 MW combustion turbine at Pulliam in 2003, $33 million for gas and electric automated meter reading modules, and $10 million for reactor vessel head replacement in 2004, and 36 million for CIS (customer information system) redesign. In addition to completed construction expenditures, construction work in progress on the Weston Unit 4 generating plant totaled $259 million at the end of 2005. This project is expected to be completed in 2008.

3. Conservation Programs

In order to reduce inefficient energy usage and the need for new expensive power plants, WPSC spent over $90.2 million for Commission-approved conservation programs for the first three years preceding the formation of the holding company (1992 to 1994). This is an average of $30.1 million per year. During this period, WPSC achieved 298 GWh of electric energy savings and 14.9 million therms of natural gas savings. This is an average of 99 GWh per year and 5 million therms per year.

In the first seven years after the holding company was formed (1995 through 2001), WPSC has spent $102.1 million for Commission-approved conservation programs. This is an average of $14.6 million per year. During this period, WPSC achieved 308 GWh and 14 million therms of natural gas savings. This is an average savings of 44 GWh and 2 million therms per year.

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[4] This table includes the primary complaint of each contact plus any secondary complaints, *i.e.* there are more complaints than the number of people who filed complaints. A report containing only the primary complaints is included on the PSCW website.

[5] In order to recognize the impacts of inflation on utility costs, Commission staff adjusted the reported construction costs to restate the figures in 2005 dollars using the Handy Whitman Index for July 1.

Since 2001, the primary responsibility for energy efficiency has transferred from the utilities to the Department of Administration (DOA). This has resulted in WPSC transferring about $8.9 million energy efficiency dollars and another $1.8 million of low-income weatherization dollars to the DOA. WPSC continues to spend over $5 million on utility energy efficiency activities. However, savings from these activities are not tracked. The decrease in WPSC spending on energy efficiency is due to the transfer of energy efficiency dollars to the DOA, not to the formation of the holding company.

3. Planning activity

In 1975, the Wisconsin legislature created Wis. Stat. § 196.491 that provided an "advance plan" process to inform the Commission and the general public of the electric utilities' plans to meet their customers' energy needs. The Commission's advance plan process required utilities to file generation, transmission and demand-side management plans every two years for Commission approval. 1997 Wisconsin Act 204 (Act 204) changed the statutes, replacing the advance plan process with a Strategic Energy Assessment (SEA). Investor-owned utilities still provide data every two years, but the Commission prepares the SEA. WPSC filed its information for the third SEA in September 2003. Additionally, WPSC conducted a need and supply planning analysis in support of its Weston Unit 4 proposal, which was also filed in September 2003. This planning analysis considered the use of renewable resources of energy and energy conservation and efficiency programs, as well as coal and natural gas supply options, to reliably provide for the energy needs of its customers.

Based on the above comments, the reliability of utility service has not been affected by the formation of WPSR.

Business of Non-utility Affiliates

The legislature found in Section 1(5) of Act 79 that:

> The public interest and the interest of investors and consumers can be benefited if public utility holding companies, in the service territories of their public utility affiliates or in this state:
>
> (a) Conduct substantial business activities.
> (b) Attract new businesses.
> (c) Expand existing businesses.
> (d) Provide investment capital for new business ventures.
> (e) Otherwise directly or indirectly promote employment and commerce.

Wis. Stat. § 196.795(7) provides that as part of the Commission's investigation of the impact of the holding company, a determination should be made whether each non-utility affiliate does one of the following:

1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail territory.
2. Increase or promote energy conservation or develop, produce or sell reusable energy products or equipment.
3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.
4. Develop or operate commercial or industrial parks in the wholesale or retail service territory of any public utility affiliate.

Appendices C, D, and E contain general information provided by WPSR. Appendix C is a copy of the WPSR organization chart dated December 31, 2005. A schedule showing the percentage of officer's time directly charged to non-utility activities, and a breakdown of the assets and employees of each non-utility affiliate located in Wisconsin and in total, as of December 31, 2005, are included as Appendix D. A brief description of each of WPSR's affiliates is provided in Appendix E.[6] Appendix E also lists the subsection of Wis. Stat. § 196.795(7) that applies to each affiliate as determined by WPSR.

Proposed Legislation

As discussed previously, Wis. Stat. § 196.795 allows public utility holding companies to diversify into non-utility investments, limited by an asset cap provision, provided such investments meet one of four criteria under Wis. Stat. § 196.795(7)(a). Act 9 modified the asset cap limitation on non-utility investments of holding company systems, pursuant to Wis. Stat. § 196.795, to allow "eligible assets" to be excluded from the calculation of non-utility assets as a percentage of utility assets. Act 9 did not, however, modify sections 1 through 4 of Wis. Stat. § 196.795(7)(a), defining appropriate non-utility investments. Therefore, an ambiguity exists between what is allowable under the definition of appropriate non-utility investments and the types of investments that qualify for inclusion under the category of "eligible assets." Not all "eligible assets" will meet at least one of the four criteria of Wis. Stat. § 196.795(7). For instance, investments in assets that process waste material, or provide telecommunication service (as defined in § 196.01 (9m)) are considered "eligible assets" but do not meet the criteria in Wis. Stat. § 196.795(7)(a).

If the non-utility investments of a public utility holding company do not, or cannot, reasonably be expected to meet one of the four criteria under Wis. Stat. § 196.795(7)(a), the holding company becomes subject to Wis. Stat. §§ 201.01(2) and 201.03(1) and the holding company is no longer exempt from the definition of a "public service corporation." Therefore, by reference, Wis. Stat. § 201.01(2) is specifically tied to the criteria in Wis. Stat. § 196.795(7)(a). Since Act 9 did not change or eliminate this reference, investments in "eligible assets" that do not meet one of the four criteria in Wis. Stat. § 196.795(7)(a) have the potential of subjecting the holding

[6] The documents labeled Appendix D and E were included in WPSR's annual holding company filing for 2005.

company to security regulation by the Commission. As a result, the holding company may not be able to issue securities without Commission approval.

It appears that the only successful way to address the ambiguities is to pursue statutory change. An addition of "eligible assets" as the fifth criteria in Wis. Stat. § 196.795(7)(a), should solve the basic problem.

Audit Report on WPS Resources Corporation

2002-2004

Objectives and Scope of Audit

The overall purpose of the audit of WPS Resources, Inc. (WPSR) was to review the operations of WPSR and various affiliated transactions for compliance with Wis. Stat. § 196.795 and affiliated interest agreements approved by the Commission. Commission staff reviewed affiliated transactions for 2003 and 2004 between Wisconsin Public Service Corporation (WPSC) and its non-utility affiliates, to determine that the costs incurred, allocation methods, and the pricing methods being used are reasonable. Selected audits performed by WPSC's Internal Auditors in 2002 and 2003 were reviewed in detail. FMV studies were reviewed for 2002-2004.

The number of detailed transactions reviewed during this audit was limited based on a favorable review of the internal controls in place at WPSC and WPSR, as well as by the affiliated interest audit done by WPSC's Internal Auditors.

WPSC was found to be in compliance with the requirements of Wis. Stat. § 196.795, affiliated interest agreements approved in dockets 9405-YO-100 and 6690-AU-103[7] for all areas reviewed, with the few exceptions detailed in Audit Findings and Recommendations below. Costs under other affiliated agreements reviewed during the last holding company audit or during various rate cases were not reviewed in detail during this audit.

If WPSR provides a response to this Audit, it will be included as Appendix F.

Audit Findings and Recommendations

Compliance with Wis. Stat. § 196.795(7)(a)

The list of non-utility affiliates provided by WPSR, included as Appendix E, includes many companies that are deemed by WPSR to be "functionally related" to the provision of utility service or to the development or acquisition of energy resources.

There is no true definition of the term "functionally related" within the Wisconsin Statutes, legislative history, or in state case law. The United States Supreme Court looked at the term "functionally related" in *Securities Industry Association v. Board of Governors of the Federal Reserve System,* 468 US 207, 82 L. Ed. 2d 158, 104 S. Ct. 3008 (1984). The court dealt with the issue of whether the Board had the power under the Bank Holding Company Act to determine if a bank holding company could acquire a non-banking affiliate engaged principally in the business of a retail securities brokerage and was "closely related" to banking. The Court noted the difference between "closely related" and "functionally related."[8] Congress was found to

[7] This docket approved the master affiliated interest agreement for services within the WPSR holding company system on May 21, 1997.

[8] See ID. at 215 n. 12.

have rejected the "functionally related" test and the Court stated it thought the "closely related" test broadened the Board's powers. Thus, it could be inferred that the "functionally related" test is more restrictive.

On this basis, it appears that several companies including, for example, Neulite Industries of Wisconsin,[9] LLC which owns and operates a light weight aggregate processing facility, and WPS Canada Generation, Inc., which owns and operates Canadian based electrical generating facilities, although related within a broad sense, may not be "functionally related" as required by this statute. These companies would likely qualify as "eligible assets."

WPSR Capital Trust 1 which arranges financing for WPSR is another company that does not fit neatly under any of the four criteria in Wis. Stat. § 196.795(7)(a), nor would it be considered an "eligible asset."[10]

Filing Requirements

The Commission order approved in docket 9405-YO-100 requires that specific information concerning the holding company and its affiliates be filed on an annual basis. All required annual filings since the formation of the holding company have been on time and are in compliance with the requirements of this order.

Docket 9405-YO-100 also requires that WPSC continue to submit 10-year financial forecasts in rate cases and other appropriate proceedings. WPSC has continued to file its 10-year financial forecasts in rate cases as required by the Commission.

Docket 6690-AU-103[11] requires that:

1. A market price study be prepared and submitted for Commission consideration on an annual basis.
2. The cost of these studies shall be allocated entirely to the holding company and not the utility.

Reports have been prepared each year as required and were made available for Commission staff review during the holding company audit. The fully loaded costs charged to WPSR for the 2002, 2003, and 2004 studies were $497,[12] $4,456, and $6,221 respectively.

Wis. Stat. § 196.795(6) requires that the holding company shall notify the Commission no more than 10 business days after the formation, organization, or acquisition of a non-utility affiliate

[9] No longer owned by WPSR at the end of 2005 and not listed in Appendix E.

[10] This company ceased to be part of the WPSR holding company system in March 2004.

[11] This docket approved the master affiliated interest agreement for services within the WPSR holding company system on May 21, 1997.

[12] Costs for 2002 were not fully tracked and charged to the holding company as determined by the Internal Audit Department at WPSC. In addition, Commission staff found that the instructions for preparation of the 2003 and 2004 studies may have lead some employees to believe their time did not need to be reported and charged to WPSR. See the findings under the transfer pricing section of this audit report.

and provide the Commission with information specified in subsections (a) to (c). For 2003 through 2004, there have been 6 notifications of new investments or acquisitions. All were received on time.

Wis. Stat. § 196.795(6)(d) requires that information on assets and employees within and outside of Wisconsin be filed annually. All reports for 2002-2004 were filed as required. A copy of the 2004 information is attached as Appendix D.

System Costs

System costs are incurred by either WPSC or WPSR, and are necessary for WPSR and its affiliates to do business as corporations. In the absence of the holding company, system costs would have been performed by the subsidiaries themselves. Some examples of these costs are maintenance of shareholder records, investor relations, and tax return preparation. These costs benefit all of the affiliates within the holding company and are known as Category 1 costs.

The Category 1 costs are allocated between the affiliates based on an average of assets, payroll, and operating expenses as of the end of the prior calendar year compared to the average of these items for the entire company. For 2001 and prior periods, a three-year average of assets, payroll and operating expenses was used. Either method would be acceptable under the affiliated interest agreement approved in docket 6690-AU-103.

Beginning in 2002, shareholder services, which are the majority of the system costs, are being contracted-out thus reducing the impact of the change in the general ratio discussed above.

Internal Audits by WPSC

WPSC's internal audit department (IA) provided a list of projects completed from 2002 to August of 2004 for our review. The Officer Expense Account Audit, Nuclear Management Company (NMC) Billing Review and the Affiliate Interest Agreement (AIA) Audit were reviewed in detail, while the findings and recommendations were reviewed for several other audits.

Officer Expense Account Audit

The objective of the 2001-2002 Officer Expense Account Audit was to determine that the expense accounts submitted comply with state and federal regulation, conform to the corporate expense account procedure and are appropriate.

According to IA, a few insignificant errors were found but they appeared to be honest mistakes without any indication of intentional abuse. Use of the automated Excel expense account worksheet rather than hand written copy would have reduced the number of errors.

In response to the audit recommendation, the WPSC weekly employee newsletter the "Contact Weekly" was used to notify employees of updates to the on-line form and to encourage use of it in 2002 and 2003.

2003 NMC Billing Review

The audit objective was to ensure the accuracy of the cost assignments and allocations from NMC to WPSC. Emphasis was on the Hudson headquarter costs, allocation methods, pension credits, direct charges, non-member assignments and true-up adjustments. IA found that cost assignment methods were well controlled. They also found that:

1. The Hudson headquarters assumes that specific plant charges have been reviewed by local site management before being passed to NMC for billing. Therefore, any cross-charged costs from a different plant should require a thorough review by site managers to verify propriety.

2. The NMC employees have the ability to charge other plants without prior authorization.

3. Standard labor rates are developed for each NMC cost center by activity type to help ensure that labor costs for time actually worked is evenly allocated to projects with a monthly true-up to adjust projects to actual cost. The standard rate for 2002 NMC labor used 2001 salaries plus 4.25 percent. Some of the 2001 salaries and vacation allowances were incorrect since 2001 salary increases were not factored in and resulted in standard rates being understated. This resulted in larger true-up to owners.

According to the IA department all audit issues have been resolved.

AIA Audit

The AIA audit completed in March of 2004 was very detailed and included most of the areas that were reviewed by Commission staff during the last holding company audit. The periods sampled were selected from 2001, 2002 and 2003. The workpapers were very professional and were relied upon to reduce the testing done by Commission staff during the current holding company audit.

Areas covered by the AIA Audit included officers' time, payroll loadings, transfer pricing, cost allocations, and compliance with statutory requirements. The audit contained the following findings and recommendations that are relevant to this audit:

1. Over one six month period sampled, officer's time (of 125 hours) was charged to WPSC that, for the most part, should have been charged to the non-utility affiliates based on their calendars. AI recommendation: Develop corporate labor reporting templates for officers to use (similar to those currently used by the CEO, CFO and Controller), provide guidance to officers regarding activities related to utility and non-utility affiliates, and identify appropriate corporate labor reporting for meetings attended by the officers.

2. Costs of preparing the annual market study were not properly accumulated and reported by some WPSC and WPSR employees. AI Recommendation: Provide employees involved in the preparation of the annual market study with additional guidance and explanation of the importance of properly reporting their corporate labor when working on their part of the annual market study.

3. The payroll loading rate for charges to another WPSR company was last updated in January 2002.

4. The market study was found to be satisfactory. Commission staff has made some recommendations for improvement under the Transfer pricing section of this report.

5. Wis. Stat. § 196.795(6) requires that the holding company shall notify the Commission no more than 10 business days after the formation, organization, or acquisition of a non-utility affiliate and provide the Commission with information specified in subsections (a) to (c). One out of seven filings that were sampled was not timely filed.

In response to the audit of officers' time, the compliance officer has communicated with officers and administrative assistants stressing the importance of appropriate time reporting. Items specifically addressed included: the importance of capturing time spent working on other companies, a reminder to administrative assistants who assist with time reporting that correct charging is important and to ask questions if needed, and a review process over the administrative assistants who complete time for officers. For staff meetings attended by senior officers, an agreement should be reached as to the amount of time to be charged to another company based on the specific topics covered.

Invoice and Payroll Sampling

As stated earlier, Commission staff relied on the WPSC internal audit department's work and only selected a small sample of invoices from WPSC to WPSR and other non-utility affiliates for cost allocation review and for compliance with the Commission approved master affiliated interest agreement. A sample of officers' timesheets for June of 2004 was also reviewed.

Commission staff found:

1. Many invoices reviewed were split between the utility and WPSR based on a cost-causation principle. The reasons for the splits were not documented on the invoices. The utility staff provided a more detailed project description and basis for these splits during the audit.

2. One invoice for the transfer of a router from WPSC to a non-utility affiliate in 2003 for $2,231 did not clearly detail the method by which the transfer price was determined. The approved affiliated interest agreement calls for the transfer to be at the greater of cost or market.

3. Calendars reviewed have more supporting detail of activities being performed as compared to the previous holding company audit. Several of the officers reviewed have time allocation worksheets for common or repetitive tasks in addition to their calendars. Another officer maintained a day book with notes in support of the information on his calendar.

4. The payroll loading rates that were revised in January 2002 according to the AIA Audit were not updated again until September 2004, based on 2003 actuals. This is the rate to be used for 2005.

Commission staff recommends:

1. That WPSC maintain documentation with each invoice to support the allocation of costs between affiliates. If a project code is assigned, a cost split for each project should be available for review by the audit staff. Documentation indicating whether property is transferred at cost or FMV, and the method used to establish FMV also needs to be retained for each invoice.

2. The payroll loading rates be reviewed annually, and adjusted every year as needed, but at least every second year.

Transfer Pricing

According to the master service agreement approved in docket 6690-AU-103, when WPSC performs services or provides assets to its non-utility affiliates, the services and assets will be billed at the fair market value (FMV) or cost, whichever is greater. When affiliates provide services to WPSC, they are billed at cost, which shall not be in excess of what it would cost to obtain similar services from a non-utility affiliate.

WPSR/WPSC prepares a detailed annual market study to determine the FMV of WPSC employee services that are shared with WPSR or other non-utility affiliates. The market studies prepared in 2002 through 2004 were reviewed during the audit.

The market studies showed that cost was approximately equal to FMV for most departments, but that FMV did exceed cost for several departments over the period reviewed. Services provided by departments that were found to be below market were marked-up to market in the billings to the parent company and other non-utility affiliates.

Overall, Commission staff found the studies sufficient to justify the decisions made regarding mark-ups to FMV. However, there were some areas where it was difficult to identify the source of the market information used in comparisons and the timeframe covered by the market information. The reasoning behind the final cost or market decision was not always obvious.

Commission staff also found that:

1. Instructions provided to the personnel preparing parts of the market study indicated that preparation costs should be charged to corporate (WPSR) unless the data was gathered for internal use (i.e. would have been gathered irrespective of the annual market study).

2. WPSC does a market comparison for several areas such as reprographics and the CADD system which are really sub-sets of the printing department. It is our understanding that these are done to determine a billing rate for these specific services. The printing

department does have a mark-up for FMV in excess of cost. Clarification is needed as to how the reviews for reprographics and CADD tie into the overall mark-up.

3. In the accounts payable area, a discount of 20 percent is given to the non-utility affiliates compared to the departments within WPSC. A discount is reasonable since the unregulated units open the mail, date stamp invoices, review invoices, obtain approvals and assign accounting, leaving less for the WPSC staff to do to complete processing. Staff was unable to verify that 20 percent would be the correct discount amount.

4. Because WPSC breaks its payroll and service categories into greater detail, it is often difficult to get a good match with local providers of similar services. Some market comparisons for labor were several years old, and it was difficult to determine if the wages were on cash only or a "fully loaded" basis.

Commission staff recommends that:

1. The annual market studies be reviewed to determine if WPSC is breaking its categories into too much detail to obtain meaningful market comparisons.

2. The annual market studies be reviewed to determine if sub-categories should be included and if so, these need to be tied to the FMV reviews at the department or functional level.

3. WPSC develop a standard format for responses from various preparers to include the source of the market information, period covered by this information, whether salary information is cash only or "fully loaded," and a concluding paragraph giving the rationale for use of cost versus market (or between several market options).

4. Instructions to those preparing the market study be revised to indicate that all time spent on gathering the data used in the study be charged to the market study and allocated to WPSR for payment, even if the data was originally gathered for another purpose.

ATC Review

In docket 05-AE-102 dated December 22, 2000, the Commission approved an affiliated interest agreement between American Transmission Company LLC (ATC) and various utilities including WPSC who contributed their transmission assets to ATC under Wis. Stat. § 196.485(3m) (the Contributing Utilities).

Under the approved agreement, ATC is required to continue to use and the Contributing Utilities are required to continue to provide "baseline maintenance hours" of at least 85 percent of the maintenance resource budget. For 2001, 2002, and 2003, WPSC provided 95.5 percent, 166.6, and 129.9 percent of the budgeted maintenance resource hours in compliance with the agreement.

Commission staff selected and reviewed transactions between WPSC and ATC in September and October 2003 for compliance with the approved agreement. No material variances were found.

Pensions and Benefits

In reviewing the pensions and benefits area, staff found that the basis for the monthly billing of active medical and dental costs in 2003 was the 2001 actual cost per employee inflated to 2003 times the number of monthly employees. This methodology corresponds with the rate case filing for the 2003 test year in docket 6690-UR-114.

The company did not update their cost per employee estimates during the year to reflect 2002 actuals, nor did they make a true-up adjustment at the end of 2003 to reflect more current cost per employee data.

Billings to WPSR or other non-utility affiliates should ultimately be based on real costs incurred and not on estimates. Commission Staff recommends that the billing process for medical and dental costs be revised to ensure that non-utility affiliates are billed for all appropriate actual costs.

WPS Investments, Inc.

WPS Investments, Inc. (WPSI) was formed to hold WPSC, UPPCO and WPSR's interests in ATC.

WPSC and UPPCO contributed transmission assets to ATC effective January 1, 2001, in exchange for equity interests in ATC. WPSR contributed it's investment in the Arrowhead Weston Line to ATC for it's equity interest.

WPSI now also holds the WPSR interest in Guardian Pipeline (Guardian),[13] which was not considered by the Commission staff at the ATC formation and the formation of WPSI.

WPSI was originally owned and controlled by the two regulated utilities. The contribution of the Arrowhead Weston Line and the subsequent transfer of WPSR's interest in Guardian has substantially changed the ownership profile of WPSI.

In early 2005, Commission staff discussed concerns about WPSI's shift in ownership, the commingling of utility and non-utility investments, and WPSI's ability to borrow funds for non-utility purposes with WPSC. These discussions resulted in an Amended and Restated Operating Agreement (Agreement) between WPSC, WPSR and UPPCO being filed in June of 2005.

The Agreement was approved in December 2005 in docket 6630-AU-109. The Agreement and Order restrict the company's investment activities to investments in ATC and Guardian and to clarify that notwithstanding Section 3.1, WPSC will not lend money to any holding company or non-utility affiliate nor guarantee the obligations of any non-utility affiliate per Wis. Stat. § 196.795(e)(c) and (d).

[13] This transfer is allowable under WPSI's Articles of Incorporation.

Action Taken 0n Prior Holding Company Audit Recommendations

1. WPSR has made process changes to ensure that notifications or new investments are received within the 10 days required by statute. All notifications reviewed for 2003-2004 were received on time.

2. Officer's monthly calendars are now being retained for at least two years in hard copy or on-line.

Conclusion

Although Commission staff does have some audit findings and recommendations related to the operation of the WPSR holding company system, WPSC and WPSR are making a good faith effort to comply with the provisions of the holding company statutes and various Commission orders. This is evidenced by WPSC's continuing efforts to monitor and improve system operations through internal audits and the training that is provided to WPSC, WPSR, and other non-utility affiliate employees on compliance with the holding company and affiliated interest statutes.

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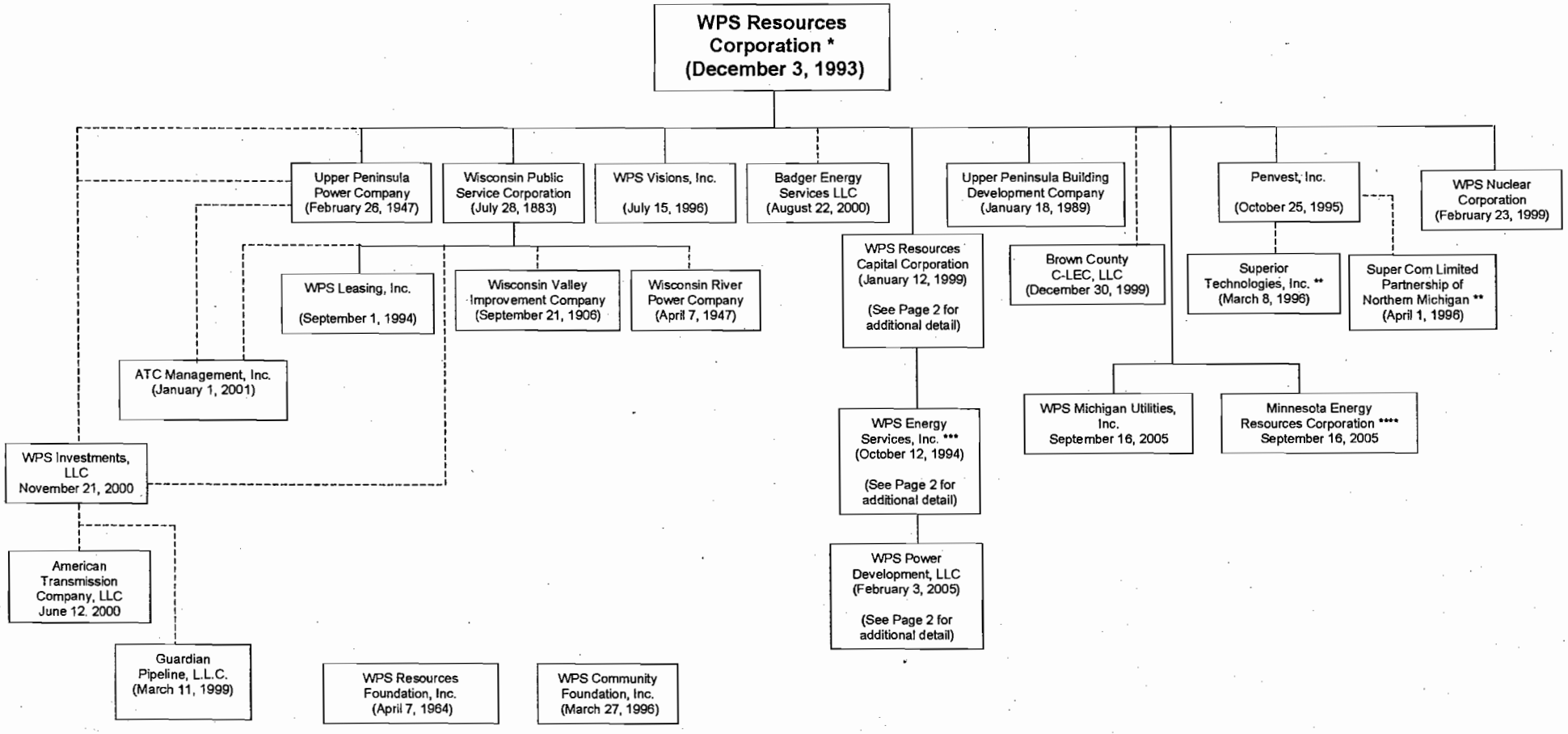
Wisconsin Public Service Corporation
Historic Rate Changes

Utility Docket		Test-Year Period	Electric Rate Cases $		Electric Rate Cases %	Electric Fuel Rules $	Electric Fuel Rules %	Gas Rate Cases $	Gas Rate Cases %
WPS									
6690-UR-117		2006 Test Year	$79,900,000		10.1%			$7,200,000	1.1%
6690-UR-116		2005 Test Year	$60,684,000		8.6%			$5,572,000	1.1%
6690-UR-115		2004 Test Year	$59,368,000		9.3%	4,800,000	0.7%	$8,863,000	2.2%
6690-UR-114		2003 Test Year	$21,378,000		3.5%	$ (2,673,000)		$ (1,225,000)	-0.3%
6690-UR-113		2002 Test Year	$58,603,000		10.9%			$10,619,000	3.9%
	(1)	ATC Surcharge	$14,110,000						
6690-UR-112		2001-2002 Biennium	$27,192,000		5.4%			$4,315,000	1.5%
6690-UR-111		1999-2000 Biennium	$26,942,000		6.3%			$10,280,000	5.1%
		Reopener (2000)	$21,051,512		4.6%				
05-ER-100	(2)	KNPP Non-fuel Surcharge	$3,783,021		.00258/kWh				
6690-UR-110	(3)	1997-1998 Biennium	$ (35,514,000)		-8.1%			$ 5,687,000	2.7%
	(4)	Kewaunee Surcharge	$ 24,500,000	(5)	5.6%				
6690-UR-109		1995-1996 Biennium	$ (10,919,000)		-2.6%				

Notes:
(1) Surcharge authorized in docket 05-EI-129.
(2) Only effective April through May of 1998 and designed to recover $3,783,021
(3) $10,894,000 subject to refund, depending on the number of maintenance outages that actually occur and the costs of replacement power.
(4) Only Effective 2/25/97 - 7/1/97. The amount shown assumes a full year's impact per the fuel auditor's estimate, the actual amount collected was approximately $7.0 million.
(5) The amount shown is total company. The order and attachments do not identify the Wisconsin retail portion.
As a result, the retail jurisdiction impacts are probably overstated by approximately 10-15%.

Appendix B

WPS Resources Corporation Organizational Chart – Page 1 of 2



* Holding company structure became effective on September 9, 1994.
** Assets sold in December 2005. Company is now inactive.
*** FSG Energy Services is a division of WPS Energy Services, Inc.
**** The Minnesota Energy Resources Corporation (formerly WPS Minnesota Utilities, Inc.) name change was effective January 3, 2006.

Prepared by: Donna M. Sheedy
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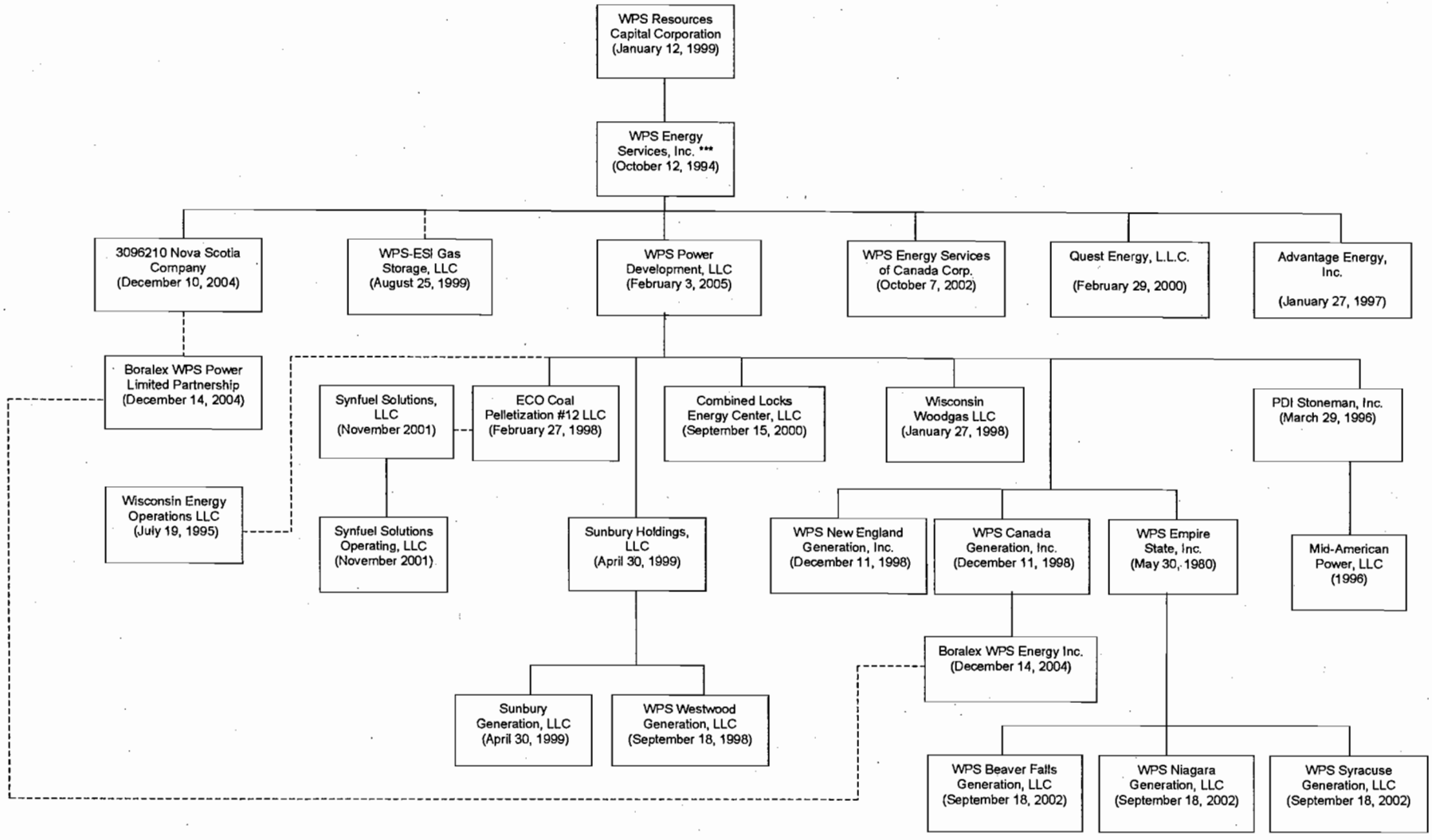
12-31-2005

Appendix C

WPS Resources Corporation Organizational Chart – Page 2 of 2



Prepared by: Donna M. Sheedy
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12-31-2005

Appendix C

File No, 9405-YO-100

Exhibit 10

Nonutility Affiliate Total Assets and Total Employees Located in Wisconsin
For the Year Ended 12/31/2005

Nonutility Affiliate	(1) Total Assets (000's)	(2) Assets in Wisconsin (000's)	Total # of Employees	Employees in Wisconsin
WPS Energy Services, Inc.*	$2,435,609	$1,484,378	422	137
WPSR Capital Corporation, Inc.	77	77	0	0
Penvest, Inc. & Upper Peninsula Building Development	6,027	0	0	0
WPS Nuclear Company	2,891	2,891	0	0
WPS Visions, Inc.	174,257	174,257	0	0
WPS Investments, inc.	216,963	216,963	0	0
WPS Leasing, Inc.	11,138	11,138	0	0
WPS Resources Corporation (3)	168,161	168,161	49	48
Total	$3,015,122	$2,057,865	471	185

(1) Amounts represent total assets at each nonutility affiliate
(2) Amounts represent total assets at each nonutility affiliate net of both depreciable assets physically located in another state as well as assets of companies headquartered in other states.
(3) Amounts represent the assets of the holding company net of its investments in subsidiaries.

*As of March 2005, WPS Power Development became a subsidiary of WPS Energy Services, Inc.

File No. 9405-YO-100 Exhibit 6 (Cont)

WPS Resources Corporation
Percentage of Officer's Time Directly Charged to Nonutility Activities
For the Year Ended December 31, 2005

Officer	Position	Percentage
Wisconsin Public Service Corporation		
Borgard, Lawrence T*	President and Chief Operating Officer - Energy Delivery	3.66%
Clausen, Pamela R	Assistant Controller	0.64%
Cloninger, Charles A*	Assistant Vice President - Operations and Engineering	6.82%
Ford, Diane L*	Vice President - Controller and Chief Accounting Officer	14.61%
Harpole, David W	Vice President - Energy Supply Projects	51.72%
Herrman, Allan D	Manager - Wholesale Services	3.97%
Jensky, Terry P.	Assistant Vice President - Energy Supply Operations	0.00%
McKee, Janet K	Assistant Treasurer	38.26%
Meinz, Thomas P*	Executive Vice President - Public Affairs	3.74%
O'Leary, Joseph P*	Senior Vice President and Chief Financial Officer	11.96%
Schott, James F	Vice President - Regulatory Affairs	4.81%
Schrock, Charles A	President and Chief Operating Officer - Generation	0.83%
Treml, Bernard J*	Senior Vice President - Human Resources	3.27%
Vanderwerff, Craig A	Assistant Controller	5.66%
Weyers, Larry L*	Chairman, President, and Chief Executive Officer	12.45%
Wiesner, George R	Assistant Controller	31.94%
Wolf, Barth J*	Secretary and Manager - Legal Services	8.87%
WPS Resources Corporation		
Bourbonais Jr, William L	Vice President - Transmission	32.12%
Charles, Michael W	Assistant VP - Development	100.00%
James, Richard E*	Vice President - Corporate Planning	28.12%
Johnson, Bradley A*	Vice President and Treasurer WPSR & WPSC	44.66%
Mikulsky, Phillip M*	Executive Vice President - Development	92.16%
Nick, Barbara A	Vice President - Corporate Services	31.14%
Schwalbach, Glen R	Assistant Vice President - Corporate Planning	32.46%
WPS Energy Services, Inc.		
Bissing, Richard J	Vice President - Gas Trading Functional Leader	99.77%
Bragg, Darrell W	Vice President - Direct Mass Markets	100.00%
Brevnov, Boris A	Vice President - Fixed Asset Mkt Management	95.73%
Cardwell, Ronnie E	Vice President - EMS & Wholesale Gas Income Stream	100.00%
Fraass, Robert A	Vice President - Finance Advantage Energy	100.00%
Spaeth, Jody M	Regional Sales Leader	100.00%
Giesler, Howard R*	Vice President - Fixed Asset Management IS	100.00%
Guc, William J*	Controller - ESI & PDI	99.59%
Radtke, Mark A*	President	100.00%
Rizor, Bruce A	Vice President - Structured Energy Trading	99.30%
Smith, Denean V	Assistant Controller	100.00%
Stanley, Ruqaiyah Z	Vice President - Account Management	99.55%
Stiers, Mark W	Vice President - C&I Electric Income Stream	100.00%
Verbanac, Daniel J*	Chief Operating Officer	100.00%
Upper Peninsula Power Company		
Erickson, Gary W*	President	4.65%

* Signifies that the officer is an officer of more than one company.

Note: The above represents officers charging time to nonutility affiliates directly. In addition, officers charge time to Category One. The Category One is allocated out in accordance with the information provided in Exhibit 5 and Exhibit 9.

File No. 9405-YO-100 **Exhibit 1**

WPS Resources Corporation (WPSR): Formed in December 1993 as a nonutility subsidiary of Wisconsin Public Service Corporation (WPSC). Became the parent holding company pursuant to Docket 9405-YO-100 on September 1, 1994.

Wisconsin Statute Section 196.795 compliance - this is the parent holding company.

Wisconsin Public Service Corporation (WPSC): Formed in July 1883 as a regulated electric and gas utility. Currently serving customers in an 11,000 square-mile area of northeastern and central Wisconsin and an adjacent portion of Upper Michigan.

Wisconsin Statute Section 196.795 compliance - #1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory.

WPS Leasing, Inc.: Formed in September 1994 as a nonutility subsidiary of WPSC to provide targeted financing to specific projects.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Investments, LLC: Formed in November 2000 as a nonutility subsidiary of Wisconsin Public Service Corporation to hold certain rights and interests in the transmission facilities of WPSC and Upper Peninsula Power Company and subsequently a membership interest in American Transmission Company. Subsequent to its formation, ownership of the company has changed as follows and will continue to change: Wisconsin Public Service Corporation owns 24.91%, Upper Peninsula Power Company owns 6.79%, and WPS Resources owns 68.3%.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

ATC Management, Inc.: Formed in January 2001 to manage the American Transmission Company, LLC. Wisconsin Public Service Corporation, Madison Gas and Electric Company, Wisconsin Power and Light Company, and Wisconsin Public Power Inc. each own 20% of the Class B voting shares.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

American Transmission Company, LLC: Formed June 2000 to maintain, own, and operate electric transmission assets in Wisconsin, Michigan, and Illinois. WPS Investments, LLC (a subsidiary of Wisconsin Public Service Corporation, Upper Peninsula Power Company and WPS Resources Corporation) owns approximately 31% of American Transmission Company, LLC.

Other contributors and, as a result, owners of American Transmission Company include: Adams-Columbia Cooperative, Alger Delta Cooperative Electric Association, City of Algoma, ATC Management Inc., WPL Transco LLC, Badger Power Marketing Authority, Central Wisconsin Electric Cooperative, Cloverland Electric Cooperative, Edison Sault Electric, City of Kaukauna, Madison Gas and Electric Company, Manitowoc Public Utilities, Marshfield Electric and Water Department, City of Menasha, City of Oconto Falls, Ontonagon County Rural Electrification Association, City of Plymouth, Reedsburg Utility Commission, Rock Country Electric Cooperative, City of Sheboygan Falls, South Beloit Water, Gas & Electric Co., City of Sturgeon Bay, City of Sun Prairie, Upper Peninsula Public Power Agency, Wisconsin Electric Power Company, Wisconsin Public Power Inc., and City of Wisconsin Rapids.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Guardian Pipeline, LLC: Formed March 1999 to own and operate the 142-mile, 36-inch gas transmission pipeline (Guardian Pipeline) extending from Joliet, Illinois to Ixonia, Wisconsin. WPS Investments, LLC owns 33-1/3% of the ownership interests in Guardian Pipeline, LLC. Additionally, Wisconsin Energy (WICOR), based in Milwaukee, Wisconsin, and Viking Gas Transmission, a wholly owned subsidiary of Omaha-based Northern Border Partners, LP, each hold a one-third interest in Guardian Pipeline, LLC.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Michigan Gas Utilities: Formed September 2005 to supply natural gas to customers in Lower Michigan. Holds and operates all of the natural gas distribution assets in Michigan that were formerly owned by Aquila, Inc. upon completion of that acquisition. Is a wholly owned subsidiary of WPS Resources Corporation.

Wisconsin Statute Section 196.795 compliance - utility affiliate.

Minnesota Energy Resources: Formed September 2005 to supply natural gas to customers in Minnesota. Holds and operates all of the natural gas distributions assets in Minnesota that were formerly owned by Aquila, Inc. upon completion of that acquisition. Is a wholly owned subsidiary of WPS Resources Corporation.

Wisconsin Statute Section 196.795 compliance - utility affiliate.

WPS Resources Capital Corporation: Formed January 1999 as an intermediate holding company for certain nonregulated subsidiaries including WPS Energy Services, Inc. and WPS Power Development, LLC and as a vehicle to provide debt financing for said nonregulated subsidiaries. In March 2005 WPS Power Development, LLC became a subsidiary of WPS Energy Services, Inc.

Wisconsin Statute Section 196.795 compliance - This has provided financing capital for WPSR, the parent holding company.

WPS Energy Services, Inc.: Formed in October 1994 to provide electric supply services and energy management to various market segments. In January 1995 this company was merged with Packerland Energy Services, Inc, a company that was formed to provide gas supply services. Is a subsidiary of WPS Resources Capital Corporation.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Energy Services of Canada Corp.: Formed in October 2002 to sell natural gas and electric energy in Canada. Is a subsidiary of WPS Energy Services, Inc.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS-ESI Gas Storage, LLC: Formed August 1999 to own a gas storage facility in Michigan. WPS Energy Services, Inc. is an 81.5% owner and Lawrence Exploration Inc. is a 18.5% owner.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Quest Energy, LLC: Formed February 2000 to operate as an electric marketer that sells energy, capacity, and related services in Michigan. Is a subsidiary of WPS Energy Services, Inc.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Advantage Energy, Inc.: Formed in January 1997 to operate as an electric marketer that sells energy, capacity, and related services in New York. WPS Energy Services, Inc. is a 100% owner of Advantage Energy Inc.

WPS Power Development, Inc.: Formed in May 1995 to participate in the development of electric generation projects and to provide services to the unregulated electric power generation industry. Is a subsidiary of WPS Resources Capital Corporation. Company was dissolved effective February 28, 2005.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Power Development, LLC: Formed in February 2005 to participate in the development of electric generation projects and to provide services to the unregulated electric power generation industry. Is a subsidiary of WPS Energy Services, Inc.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Visions, Inc.: Formed in July 1996 as a subsidiary of WPS Resources Corporation in order to participate in the development of a national marketing concept. In July 2004, entered into a purchase agreement for condominiums located in Wausau, Wisconsin. The organization was inactive prior to 2004.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

PDI Stoneman, Inc.: Formed in March 1996 as a subsidiary of WPS Power Development, LLC. Owns 100% of Mid-American Power, LLC. Purchased the 33-1/3% interest in Mid-American Power, LLC that had been owned by Burns and McDonnell on September 19, 2003, resulting in 100% ownership and 100% ownership of the Stoneman plant.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

PDI Operations, Inc.: Formed in May 1996 as a subsidiary of WPS Power Development, LLC to provide operating services to the Stoneman power plant and other energy projects. Name was changed from PDI Stoneman Operations, Inc. to PDI Operations, Inc. on May 15, 1997. Company was dissolved effective December 31, 2005.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Mid-American Power, LLC: Formed during 1996 as the owner of the Stoneman facility. Is a subsidiary of PDI Stoneman, Inc. PDI Stoneman, Inc. purchased B.M. Stoneman, Inc.'s (a subsidiary of Burns & McDonnell) 33-1/3% ownership interest in Mid-American Power, LLC on September 19, 2003.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Mid-American Power Ventures, LLC: Formed in August 1996 to develop power production facilities with other partners. Is a subsidiary of WPS Power Development, LLC. WPS Power Development, LLC purchased Burns and McDonnell's 25% ownership interest in 1996 resulting in 100% ownership interest by WPS Power Development. Company was dissolved effective December 31, 2005.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Upper Peninsula Power Company (UPPCO): Originally formed in February 1947 but acquired as the result of a merger with UPEN, Inc. September 1998. A regulated utility supplying electric energy to customers in Michigan's Upper Peninsula. Is a subsidiary of WPS Resources Corporation.

Wisconsin Statute Section 196.795 compliance - utility affiliate.

Upper Peninsula Building Development Company: Originally formed in January 1989 but acquired as the result of a merger with UPEN, Inc. September 1998. Owns and leases corporate headquarters to Upper Peninsula Power Company. Is a subsidiary of WPS Resources Corporation.

Wisconsin Statute Section 196.795 compliance - since the primary asset of this company is the office building in Houghton, Michigan it has supported jobs (i.e. construction, building maintenance, etc.) and helped growth (the building also houses Michigan Tech people) in the service territory of UPPCO.

Penvest, Inc.: Originally formed in October 1995 but acquired as the result of a merger with UPEN, Inc. September 1998. Holds investments in communications, and real estate. Is a subsidiary of WPS Resources Corporation.

Wisconsin Statute Section 196.795 compliance - #1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory, within or outside this state, of: (a) any public utility affiliate; (b) any public utility or member of a cooperative association organized under ch. 185 which files or has filed a plan under s. 196.491(2).

Renewable Fibers International, LLC: Formed January 1998 to develop and operate business activities related to the continuous fiber liberation of wood chips which is a more efficient process for paper companies. WPS Power Development, Inc. has a 33-1/3% membership interest and Hoffman Environmental Systems, Inc. has a 66-2/3% membership interest. Company dissolved effective December 31, 2005.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop, produce, or sell renewable energy products or equipment.

Wisconsin Woodgas, LLC: Formed January 1998 to own and operate a gasification facility that converts biomass feedstock into biomass gas for sale to Wisconsin Energy Operations LLC. Is a subsidiary of WPS Power Development, LLC.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop, produce, or sell renewable energy products or equipment.

Wisconsin Energy Operations, LLC: Formed July 1995 to own and operate a facility that generates process steam for sale to Webster Industries Incorporated. WPS Power Development,

LLC has a 49% membership interest and Webster Industries Incorporated has a 51% membership interest.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop, produce, or sell renewable energy products or equipment.

ECO Coal Pelletization #12, LLC: Formed February 1998 to indirectly own and operate a facility that combines coal fines and a binder material to create coal briquettes. 100% Class A interests (preferred interests) owned by undisclosed non-affiliated third party. 100% Class B interests (voting/control interests) owned by WPS Power Development, LLC.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Synfuel Solutions, LLC: Formed in November 2001 to indirectly own and operate Synfuel Solutions Operating, LLC, a facility that combines coal fines and a binder material to create coal briquettes. ECO Coal Pelletization #12, LLC owns a one-third interest in Synfuel Solutions, LLC.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop, produce or sell renewable energy products or equipment.

Synfuel Solutions Operating, LLC: Formed in November 2001 to own and operate a facility that combines coal fines and a binder material to create coal briquettes. Owned 100% by Synfuel Solutions, LLC.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop, produce or sell renewable energy products or equipment.

Nuclear Management Company, LLC: Formed during 1999 to provide maintenance, operation, and decommissioning services to nuclear power plants. Owned one-fifth each by WPS Nuclear Corporation, WEC Nuclear Corporation, NSP Nuclear Corporation, Alliant Energy Nuclear, LLC, and Consumers Energy. As of July 2005, the partial interest in Nuclear Management Company, LLC was terminated with the sale of the Kewaunee Nuclear Plant.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Nuclear Corporation: Formed in February 1999 as a subsidiary of WPS Resources Corporation to own a partial interest in Nuclear Management Company, LLC. As of July 2005, the partial interest in Nuclear Management Company, LLC was terminated with the sale of the Kewaunee Nuclear Plant.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS New England Generation, Inc.: Formed in December 1998 as a subsidiary of WPS Power Development, LLC for the ownership and operation of United States based electrical generating facilities and related transmission facilities acquired from Maine Public Service Company.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Canada Generation, Inc.: Formed in December 1998 as a subsidiary of WPS Power Development, LLC for the ownership and operation of Canadian based electrical generating facilities and related transmission facilities acquired from Maine Public Service Company.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Sunbury Holdings, LLC: Formed in April 1999 as a subsidiary of WPS Power Development, LLC to be a holding company for Sunbury Generation, LLC and WPS Westwood Generation, LLC.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Sunbury Generation, LLC: Formed in April 1999 as a subsidiary of Sunbury Holdings, LLC to own generating assets in Pennsylvania.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Westwood Generation, LLC: Formed in September 1998 as a subsidiary of Sunbury Holdings, LLC and owns a circulating fluidized bed plant located in Pennsylvania.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Combined Locks Energy Center, LLC: Formed in September 2000 as a 100% owned subsidiary of WPS Power Development, LLC. Combined Locks Energy Center is a steam and electric power production facility located in Combined Locks, Wisconsin at the Appleton Coated paper mill site. The company sells steam on site to the paper mill and sells electricity to the wholesale electric market.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Empire State, Inc.: Formed May 1980 as a sole owner of three cogeneration facilities and operator of all generation assets owned by the three facilities. Assets were acquired as part of the CH Resources, Inc. acquisition on May 31, 2002. Is a subsidiary of WPS Power Development, LLC.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Niagara Generation, LLC: Formed September 2002 as owner of the Niagara Falls generating facility. The former WPS Niagara Properties, Inc. acquired as part of the CH Resources, Inc. acquisition on May 31, 2002, was merged into WPS Niagara Generation, LLC on October 1, 2003. Is a subsidiary of WPS Empire State, Inc.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Syracuse Generation, LLC: Formed September 2002 as owner of the Syracuse generating facility. The former WPS Syracuse Properties, Inc was acquired as part of the CH Resources, Inc. acquisition on May 31, 2002, and was merged into WPS Syracuse Generation, LLC on October 1, 2003. Is a subsidiary of WPS Empire State, Inc.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

WPS Beaver Falls Generation, LLC: Formed September 2002 as owner of the Beaver Falls generating facility. Was acquired as part of the CH Resources, Inc acquisition on May 31, 2002. Did not become an active legal entity until October 1, 2003. Is a subsidiary of WPS Empire State, Inc.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Brown County C-LEC, LLC: Formed during 1999 to provide competitive local exchange service and telephone communication service in the Green Bay, Appleton, and De Pere areas of Wisconsin. Owned 40% by WPS Resources and 60% by NET-LEC, a wholly owned subsidiary of Northeast Communications of Wisconsin.

Wisconsin Statute Section 196.795 compliance - #1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory, within or outside this state, of: (a) any public utility affiliate; (b) any public utility or member of a cooperative association organized under ch. 185 which files or has filed a plan under s. 196.491(2).

Superior Technologies, Inc: Originally formed in March 1996 but acquired as a result of a merger with UPEN, Inc. in September 1998 whose purpose is to research and develop

telecommunication applications related to utilities. The telecommunications company is owned one-third by Penvest, Inc. and two-thirds by A. William Stark. Assets of the company were sold on December 30, 2005, and the company is now inactive.

Wisconsin Statute Section 196.795 compliance - #1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory, within or outside this state, of: (a) any public utility affiliate; (b) any public utility or member of a cooperative association organized under ch. 185 which files or has filed a plan under s. 196.491(2).

Super Com, LLP: Originally formed in April 1996 but acquired as a result of a merger with UPEN, Inc. in September 1998 to operate a paging service. Is owned 10% by the general partner, Superior Technologies, Inc., 22.5% by Penvest, Inc., and 67.5% by A. William Stark. Assets of the company were sold on November 30, 2005, and the company is now inactive.

Wisconsin Statute Section 196.795 compliance - #1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory, within or outside this state, of: (a) any public utility affiliate; (b) any public utility or member of a cooperative association organized under ch. 185 which files or has filed a plan under s. 196.491(2).

Badger Energy Services LLC: Formed August 2000 to sell propane and related energy services in Wisconsin. WPS Resources Corporation, Oconto Electric Cooperative, Central Wisconsin Electric Cooperative, Adams-Columbia Electric Cooperative, Larsen Cooperative, Tomorrow Valley Cooperative Services, Bay Lakes Cooperative and Scenic Valley Cooperative each own one-eighth of this limited liability company.

Wisconsin Statute Section 196.795 compliance - #3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Wisconsin River Power Company: Formed April 1947 to operate two hydroelectric plants on the Wisconsin River and proportionately sell the energy output to the two companies which own all of the outstanding shares of stock of Wisconsin River Power Company. Wisconsin Public Service Corporation and Wisconsin Power and Light Company each own 50% of Wisconsin River Power Company.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop produce or sell renewable energy products and equipment.

Wisconsin Valley Improvement Company: Formed September 1906 to operate a system of dams and water reservoirs on the Wisconsin River and tributary streams to produce as nearly a uniform stream flow as practicable through all seasons. Charges water tolls to benefited power plant owners as determined semiannually by the Public Service Commission of Wisconsin. Wisconsin Public Service Corporation owns 27.1%, Consolidated Water Power owns 23.5%, Wisconsin River Power Company owns 14%, Wisconsin Power and Light Company owns

12.3%, Domtar Wisconsin Dam Corporation owns 10.6%, Wausau-Mosinee Paper Corporation owns 3.2%, Weyerhaeuser Company owns 3%, PCA Hydro, Inc. owns 2.7%, Rhinelander Paper Company owns 2%, and Tomahawk Power & Pulp owns 1.6%.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop produce or sell renewable energy products and equipment.

WPS Resources Foundation, Inc.: Formed April 1964 to provide charitable contributions.

Wisconsin Statute Section 196.795 compliance - #1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory, within or outside this state, of: (a) any public utility affiliate; (b) any public utility or member of a cooperative association organized under ch. 185 which files or has filed a plan under s. 196.491(2).

WPS Community Foundation, Inc.: Formed March 1996 to funds solar use.

Wisconsin Statute Section 196.795 compliance - #2. Increase or promote energy conservation or develop produce or sell renewable energy products and equipment.

3096210 Nova Scotia Company: Formed December 2004 as a subsidiary of WPS Energy Services, Inc. organized to facilitate a response to a request for proposal for electric supply issued by the Ministry of Energy of the Province of Ontario. Holds a 49.9% limited partner interest in Boralex WPS Power Limited Partnership.

Wisconsin Statute Section 196.795 compliance - currently inactive.

Boralex WPS Power Limited Partnership: Formed December 2004 and organized to facilitate a response to a request for proposal for electric supply issued by the Ministry of Energy of the Province of Ontario. Will produce and supply electric power in Ontario, Canada. 3096210 Nova Scotia Company owns 49.9% and Boralex WPS Energy, Inc. owns .2%.

Wisconsin Statute Section 196.795 compliance - currently inactive.

Boralex WPS Energy Inc.: Formed December 2004 and organized to facilitate a response to a request for proposal for electric supply issued by the Ministry of Energy of the Province of Ontario. Serve as the general partner of Boralex WPS Power Limited Partnership and own 0.2% of Boralex WPS Power Limited Partnership. WPS Canada Generation, Inc. owns 50% of the outstanding shares.

Wisconsin Statute Section 196.795 compliance - currently inactive.

WPS Resources Corporation
700 North Adams Street
P.O. Box 19001
Green Bay, WI 54307-9001

November 21, 2006

Mr. Robert Norcross
Administrator, Electric Division
Public Service Commission of Wisconsin
610 North Whitney Way
P. O. Box 7854
Madison, WI 53707-7854

Dear Mr. Norcross:

We appreciate the opportunity to comment on the Draft Report to the Legislature on WPS Resources Corporation (WPSR) compliance with the Wisconsin Holding Company Statutes.

Comments on Recommendations

Page 6 – Invoice and Payroll Sampling

1. WPSC will improve its documentation process to ensure that there is adequate support for all allocations on invoices. We will also ensure that there is adequate documentation on minor property transfers.

2. WPSC agrees to review payroll loading rates at least annually and adjust at least every second year.

Page 7 – Transfer Pricing

1-2. WPSC will review its annual market study process to assess if categories can be consolidated or broken out differently for easier cost comparison.

3-4. WPSC also agrees to clarify the instructions for those doing market studies so it is clear that all time spent doing this should be charged to WPSR so there is consistent information collected and it is clearly labeled.

Page 8 – Pensions and Benefits

1. WPSC will review its billing process for medical and dental to ensure actual costs are billed to all affiliates.

WPSR appreciates the professional manner with which the PSCW staff conducted their audit. We also appreciate the flexibility in scheduling the audit around our many deadlines.

If you have any questions, please call me at 920-433-1453.

Sincerely,

Diane L. Ford
Vice President – Controller
Chief Accounting Officer

plh

cc - Diane Braun – PSCW
Sandy Jackson – G5
Joe O'Leary – G6
Jim Schott – G3
Larry Weyers – G6
Barth Wolf – G6
Corporate Files – G6

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