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Public Service Commission of Wisconsin
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Audit Report on Wisconsin Energy Corporation

2006

Approved by the Commission: November 16, 2007

Public Service Commission of Wisconsin

Daniel R. Ebert, Chairperson
Mark Meyer, Commissioner
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610 North Whitney Way
P.O. Box 7854
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November 16, 2007

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

Mr. Patrick 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 Wisconsin Energy Corporation — File 9402

Dear Mr. Marchant and Mr. Fuller:

The enclosed audit report on Wisconsin Energy Corporation and its impact on the operations of Wisconsin Electric Power Company was prepared as required by Wis. Stat. § 196.795(7)(ar) for distribution to the Legislature under Wis. Stat. § 13.172(2).

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

SJP:DCB:g:\holding company\reports\WEC\Cover letter for WEC HC Report to Assembly and Senate

WISCONSIN ENERGY CORPORATION

PUBLIC SERVICE COMMISSION OF WISCONSIN

REPORT TO THE LEGISLATURE

Introduction

When the Wisconsin Legislature enacted Wisconsin Act 79 (the Holding Company Statute) in 1985[1] it created legislation regulating the formation and continuing operation of public utility holding company systems in this state. As part of that regulation the Commission is required to submit a report to the legislature on the impacts of the holding company system, both beneficial and adverse, on its public utility affiliates and their investors and consumers.[2] Periodic audits are also required by statute.

The following report describes the Wisconsin Energy Corporation (WEC) holding company system, its impacts on the utilities encompassed by it, as well as any identifiable impacts on investors or consumers. The time period covered by the financial section of this report is from 2002 through 2006.

The most recent audit report, which focused primarily on 2004-2005 transactions, is included as Appendix A

Executive Summary

WEC was incorporated in Wisconsin in 1981 and became a diversified holding company in 1986 after the passage of the Holding Company Statute. Since then both the holding company and the legislation regulating it have changed. Wisconsin Electric Power Company (WEPCO) transferred its transmission assets to American Transmission Company LLC (ATC) as provided in Wis. Stat. § 196.52(9) on January 1, 2001. WEC, in an attempt to return to "basics," sold its manufacturing segment in 2004.[3] With the advent of "the Leased Generation Law," as enacted by the Wisconsin Legislature as part of 2001 Wis. Act 16, generation can now be utility-owned, leased from a utility affiliate,[4] or contracted for from an independent power producer. These changes make it difficult to judge the impact of the holding company system on the public utility. However, it is apparent that some of the financial insulation that existed between the holding company and its public utility affiliates has disappeared.

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[1] 1985 Wisconsin Act 79 creating Wis. Stat. § 196.795 was passed in November 1985.

[2] Wis. Stat. § 196.795(7)(ar).

[3] On April 26, 2000, WEC acquired WICOR, Inc. (WICOR). WICOR is the parent of Wisconsin Gas Company (WGC or WG), and of WICOR Industries, an intermediary holding company, and its three primary subsidiaries: Sta-Rite Industries, Inc., SHURflo Pump Manufacturing Company and Hypro Corporation. WICOR Industries, Inc. was the segment sold in 2004.

[4] Leased generation contracts were approved by the Commission in dockets 05-AE-109 and 05-AE-118.

Wisconsin Energy Corporation

WEC's system can be broken down into two primary segments. Referring to the organization chart in Appendix B, the companies in the gas and energy sectors are listed in the outside columns while the nonutility related companies are in the center column of page one with the second and third tier affiliates listed on subsequent pages.

The utility subsidiaries are WEPCO, Edison Sault Electric Company (Edison Sault), and Wisconsin Gas LLC (WG). WEPCO and Edison Sault together serve over 1,125,200 electric customers in Wisconsin and the Upper Peninsula of Michigan at December 31, 2006. WEPCO's gas segment and WG serve approximately 1,041,400 gas customers in Wisconsin. WEPCO also serves about 460 steam customers in metro Milwaukee, Wisconsin, and about 3,000 water customers in suburban Milwaukee, Wisconsin.

In April 2002, WEPCO and WG began doing business under the trade name of "We Energies."

The energy related non-regulated segments include W.E. Power, LLC (We Power), WEC Nuclear Corporation, and Wisvest Corporation (Wisvest). We Power was formed in 2001 to design, construct and own the new electric generating capacity included in the WEPCO's *Power the Future* (PTF) strategy. WEC Nuclear Corporation holds WEC's investment in Nuclear Management Company, LLC (NMC).[5]

Holding Company System Impact

Since 1985, public utilities have been allowed to diversify by forming holding companies. Diversification was promoted as an economic development tool. Therefore, the Holding Company Statute contains conditions requiring the non-utility activities of a public utility holding company to promote business activity, employment, and business capital within the state. Opponents to public utility diversification raised concerns regarding the impact of diversification on the public utility and the public interest. To ensure the integrity of the public utility and protection of the interest of its ratepayers, shareholders and the general public, the statute conditions approval of public utility holding companies on:

- continued regulation of the public utility and its interactions with its affiliates (allocation of costs, reasonable rates, affiliated interest approval, access to books and records); and
- maintenance of a competitive environment (non-utility activities should not lessen competition, restrain trade, create a monopoly or constitute unfair business practice); and
- maintaining a healthy public utility (maintenance of management focus on the provision of utility service, maintaining reliable utility service, maintaining the utility as the predominant business of the holding company system, and insulating the utility from

[5] The Commission approved WEPCO's sale of its Point Beach Nuclear Plant to FPL Energy, a subsidiary of FPL Group, Inc. in docket 6630-EI-113 on September 25, 2007. FPL Energy assumed management and operation of Point Beach from NMC.

activities of the holding company system – no material impact on public utility rates, cost of capital or ability to raise capital).[6]

The audit report included as Appendix A to this report discusses Commission staff's audit findings and recommendations related to compliance with Wis. Stat. §§ 196.795(6)(a), 196.795(7)(a), and provisions of the affiliated interest agreement approved by the Commission in docket 05-AE-105.[7]

The following discussion summarizes the impact WEC has had on its public utility affiliates and on the investors and consumers of the public utility affiliates as set forth in Wis. Stat. §§ 196.795(4), 196.795(6)(6m), and various sections of 196.795(5). 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 Nonutility Business

A purpose of the holding company act as originally drafted was that the provision of "reasonably priced and reliable public utility service" be the predominant business of a public utility holding company system.[8] This was accomplished through the asset cap portion of the statute.[9] The asset cap restricts the sum of the assets of all non-utility affiliates to the sum of 25 percent of electric utility and 25 percent or more of the assets used to provide other utility services (i.e., gas and steam). The Commission's formation order for WEC, docket 9402-YO-100, set the level of nonutility assets at 25 percent for the steam and gas utilities

The assumption of utility predominance in a holding company structure was affected by the passage of asset cap relief in October 1999, when Wisconsin Act 9 (Act 9) created Wis. Stat. § 196.795(6m)(e). This statute 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).[10] A category called "eligible assets" was created. Eligible assets are assets in qualified non-utility investments that are excluded from the calculation of the asset cap.

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[6] Section 1(7) of 1985 Wisconsin Act 79 - see Appendix H for detail.

[7] Wis. Stat. § 196.795(5)(j) provides that public utility affiliates (WEPCO and WG) are subject to every law, regulation, and precedent application of the regulation of public utilities, which includes Commission approval of affiliated interest transactions.

[8] Section 1(7)(f) of 1985 Wisconsin Act 79.

[9] Wis. Stat. § 196.795(6m)(b) – note in 1999 Wisconsin Act 9, Wis. Stat. § 196.795(5)(p) was renumbered Wis. Stat. § 196.795(6m)(b).

[10] Effective on January 1, 2001, WEPCO and Edison Sault Electric Company (Edison Sault) transferred their electric transmission system assets to American Transmission Company LLC in exchange for equity interests in this new company. As a result of the transfer of these assets, WEC 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).

In 1999, before the passage of Act 9, the nonutility investment was at 23.09 percent and this dropped to 7 percent in 2000 after excluding "eligible assets" from the computation. As of December 31, 2006, nonutility assets of WEC, after excluding eligible assests, equaled only 2.64 percent of total combined electric, gas, and steam utility assets. As of the end of 2006, 25 percent of total combined utility assets amounted to $2,036 million. Total nonutility assets as of the end of 2006 were approximately $215 million as shown in more detail in Table 1 which summarizes the relative size of nonutility assets from 2002 through 2006 as calculated pursuant to the asset cap in Wis. Stat. § 196.795(6m).

Table 1
Wisconsin Energy Corporation
Utility and Nonutility Assets
(In Millions)

	2006	2005	2004	2003	2002
Consolidated Utility Subsidiaries[11]	8,145	7,984	7,003	6,617	6,370
Consolidated Non-utility Affiliates and WEC	215	420	397	345	342
WEC Consolidated	8,360	8,404	7,400	6,962	6,712
Nonutility Investment Percent	2.64%	5.27%	5.67%	5.22%	5.37%
25% of Total Combined Utility Assets	2,036	1,996	1,751	1,654	1,593

B. Financial

Wis. Stat. § 196.795(5)(g) provides that no holding company system may be operated in any way that materially impairs the credit or ability to acquire capital on reasonable terms of any public utility affiliate in the holding company system.

1. Credit Ratings

Page 1 of Appendix D contains the bond and security ratings history for Wisconsin Energy Corporation for the years 2000 through 2006. Moody's lowered WEC's rating for senior unsecured debt in 2002. Standard and Poor's (S&P) lowered its rating in 2001 and again in 2003. Fitch lowered its rating in 2002 and 2003. WEC's senior unsecured debt ratings have not changed since 2003 for any of the three rating agencies. In its 2006 10-K, WEC's security ratings outlook was "stable" for Moody's and S&P and "negative" for Fitch.

WEPCO has a higher credit rating than WEC due to regulatory insulation that requires WEPCO to maintain a specified equity component in its total capitalization.

2. Impairment of Capital Structure

One of the important issues in situations where a public utility is held by a holding company is the question of whether or not the parent company is conducting itself in a manner that impairs the credit quality of the public utility subsidiary. Answering this question requires a

[11] Utility subsidiaries include WEPCO, WG, and Edison Sault.

determination as to whether or not a public utility would have the same credit rating on a stand-alone basis as it does as a subsidiary of its holding company.

Commission staff reviewed rating company reports (S&P's, Moody's, and Fitch) to search for information that would indicate that the conduct of a parent company was having an adverse impact on the financial rating of the public utility subsidiary.

Some rating agency comments hint at the possibility that the credit rating of the utility subsidiary would be higher as a stand alone company versus a subsidiary in its holding company. For example:

> WEPCO's ratings are constrained by those of its more highly levered parent, Wisconsin Energy Corp.—Fitch Ratings, July 7, 2006
>
> The corporate credit ratings on WEPCO and WG are one notch higher than their parent from regulatory insulation provided to all Wisconsin utilities based on the PSCW's authority to mandate a utility's capital structure and restrict dividends to parents.—Standard and Poor's, March 30, 2005

Commission staff attempted the "direct approach"—asking the representatives of the rating companies who wrote the reports what they believed WEPCO's credit ratings would be if they were a "stand alone" company. The response from these representatives was that only the parent company was truly being evaluated and not the public utility subsidiaries.

Rating agencies tend to guard their bases for making rating decisions. It can be difficult to obtain guidance from a rating agency as to why an entity is given a certain rating. Complicating matters is the fact that rating agencies have their own benchmarks and, in a number of cases, give the same utilities different ratings. For example, Fitch's ratings for WEPCO's bonds and unsecured debt are higher than the ratings given by Standard and Poor's. (***See*** Appendix D, page 2.) If there are no common benchmarks for various measures of financial strength, it makes comparisons more difficult. Commission staff needed to find at least one rating agency where there is enough information on benchmark values and methods for calculating financial strength so that a determination might be made as to whether or not the public utility would get the same credit ratings on a stand alone basis as they currently receive as a subsidiary of a holding company.

Commission staff believes that S&P has provided enough information to allow a determination to be made. Commission staff is relying on information included in S&P's September 14, 2006, Research, *Key Credit Factors: Assessing U. S. Vertically Integrated Utilities' Business Risk Drivers* concerning industry benchmarks for adjusted total debt to total capital, considering the company's business profile score provided by S&P.

Two of the major sources of adjustments to a company's balance sheet are capital lease obligations which constitute off-balance sheet financing and unfunded post-retirement obligations (which is addressed in S&P's publication, *Corporate Rating Criteria—2006.*) The net present value of off-balance sheet obligation payments may be distilled down to a debt-equivalent which needs to be considered in calculating the total adjusted debt and the total adjusted interest expense. Commission staff evaluated WEPCO's capital lease payments and

concluded that the appropriate debt-equivalent is roughly $180 million for 2006. These adjustments also apply to WEC, since the obligations are with third parties to WEC's holding company structure.

Unfunded pension and post-retirement obligations have a dual impact on capital structure, according to S&P's *Corporate Rating Criteria—2006* publication. The first impact is on long-term debt and total adjusted interest expense. The unfunded accumulated benefit represents a liability to the company. The second impact is on common equity and funds from operations. The difference between the unfunded accumulated benefit obligation and the liability on the balance sheet for such obligations represents a future charge to income and common equity. Both impacts are calculated net of the composite income tax rate since these represent expenses that are deductible for tax purposes. S&P provided those amounts for WEC in its discussion of securities ratings for WEPCO, which were filed confidentially with the Commission from WEPCO.

Commission staff was able to replicate S&P's adjustment to long-term debt from the unfunded pension and post-retirement obligation for WEC. Commission staff then made the same calculation for WEPCO. This figure was then used to adjust WEPCO's long-term debt. Commission staff then took the ratio of WEPCO's adjustment to long-term debt to WEC's adjustment to long-term debt and applied that ratio to S&P's estimated impacts for WEC for adjustments to equity, interest expense and funds from operations to arrive at the estimated impacts of those items on WEPCO's financial measurements.

Appendix E shows Commission staff's estimations of the S&P ratings for various financial parameters, along with Commission staff's interpolations of ratings for these various financial parameters in keeping with the guidelines provided in the September 14, 2006, S&P Research. Due to the fact that the actual values of the financial parameters have been declared to be confidential by WEC, Commission staff shows only the ratings associated with the parameters along with the rating limits, based on the entity's business profile score (BPS). Appendix E shows three financial parameters for the entities: (1) total debt to total capital percentage; (2) funds from operations (FFO) to total debt percentage; and (3) FFO times interest coverage.

Page 1 of Appendix E shows WEC's ratings for actual 2005 and forecasts for years 2006-2010. The ratings associated with the 2006-2010 average values are BBB, BBB, and A respectively. The S&P rating for WEC's unsecured senior debt is BBB+ with a stable security rating outlook. This overall rating is in keeping with the ratings for the individual parameters. WEC benefits from the cash flows of its utility subsidiaries, demonstrated by the "A" rating for the FFO times interest coverage parameter. WEC's capital structure is significantly impacted by its off balance sheet obligations (OBSO) and unfunded pension and post-retirement benefit obligations.

Page 2 of Appendix E shows WEPCO's ratings for actual 2005 and forecasts for years 2006-2010. The ratings associated with the 2006-2010 average values are BBB+, BBB+, and AA-, respectively. The S&P rating for WEPCO's secured senior debt and unsecured debt is A-, with a stable security ratings outlook. Given the ratings that Commission staff estimated for the three parameters in question, it would appear that a rating of A- is in keeping with those values—therefore, it appears that there is no evidence of impairment of capital by WEC on WEPCO's financial condition. WEPCO's capital structure also is significantly impacted by its OBSO and

unfunded pension and post-retirement benefit obligations. It appears that S&P did not impute the Power the Future (PTF) leases as debt against WEPCO, which is consistent with what the Commission was told in the PTF proceedings.

3. Commission-Imposed Requirements

In its order in docket 9402-YO-100, the Commission found that the fundamental requirement for meeting the obligation to serve at reasonable cost is the continuing financial health of the utility. The Commission found that three elements of utility finance help to ensure that utilities are able to provide reliable, low cost service into the future:

- A reasonable and balanced capital structure;
- A dividend policy based on the utility's needs; and
- A commitment to fund capital construction needed to provide safe and reliable utility service.

a. Reasonable and Balanced Capital Structure

Appendix D of this report contains the year-end capitalization dollars and percentages for WEC and its utility subsidiaries. For WEPCO and WEC, two capitalizations are shown. The first is the booked capitalization. This contains the companies' securities that are recorded on the balance sheet. However, not all indebtedness is recorded on the balance sheet. In light of concerns regarding the amount of off-balance-sheet indebtedness, the second capitalization incorporates adjustments for OBSO. The OBSO consist of 40 percent of the present value (10 percent discount factor) of purchased power agreements.

In the Commission's order in WEPCO's most recent rate case (docket 05-UR-102), the Commission found that a long-term range of 48.5 to 53.5 percent common equity is reasonable. The actual 2005 and the forecasted 2006-2010 financial capital structure for WEPCO is within this range.

b. Dividend Policy

In prior rate orders the Commission has determined that off balance sheet financing should be included when determining appropriate debt and equity levels for public utilities, but not in setting utility rates. In its order in docket 05-UR-102, dated January 26, 2006, the Commission found that a reasonable utility ratemaking capital structure for WEPCO for the 2006 test year consists of 56.34 percent common equity, 0.73 percent preferred stock, 36.46 percent long-term debt, and 6.47 percent short-term debt. For WG, the Commission found that a reasonable capital structure consists of 50.20 percent common equity, 36.20 percent long-term debt, and 13.60 percent short-term debt. The Commission found that a reasonable financial equity range is from 48.5 percent to 53.5 percent.

The Commission determined that assessing the reasonableness of the utility's capital structure depends upon three important principles. First, capital structure decisions must be based on the utility's needs, not the needs of the non-utility operations of the holding company. Second, the capital structure should provide adequate flexibility to the utility and to the Commission to allow proper utility investment now and in the future. Third, the dividend policy of the utility should

not exceed typical utility dividend practices such as whenever the utility is below the estimated test year common equity ratio.

The utility's needs must take precedence over non-utility needs if ratepayers are to be protected. Wis. Stat. § 196.795 clearly 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. The utility must have flexibility to finance both foreseen and unforeseen capital requirements.

In docket 9402-YO-100, 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. Protection of the ratepayers' interest and the utility needs requires a capital structure and dividend policy which maintains the projected test year financial integrity of the utility. This can be partially accomplished by paying no more than a typical utility dividend. Such a dividend policy will serve to maintain the utility common equity ratio near the test year authorized in the event that other forecasts are realized. Attempting to maintain the utility common equity ratio near the test year authorized level is important since ratepayers are paying for that level of equity. Therefore, proper ratepayer protection requires that no dividend payments in excess of those forecasted in a rate case be paid prior to the end of the test year. At the end of the test year, a special dividend may be paid in excess of the forecasted dividends only if the additional payment does not reduce the average ratemaking common equity ratio below the test year forecasted level (56.34 percent in docket 05-UR-102).

Similarly, in annual periods subsequent to the test year, ratepayer protection requires that no dividends in excess of a typical utility dividend be paid prior to the end of each year. At the end of each year, a special dividend may be paid in excess of a typical dividend only if the additional payment does not reduce the average annual ratemaking common equity ratio below the test year forecasted level (56.34 percent in docket 05-UR-102).

For 2003-2006, the dividends paid by WEPCO to WEC were $179.6 million each year according to WEPCO's 2005 and 2006 10-K SEC filings. While the actual annual ratemaking common equity ratio has been below the test year forecasted level, dividends have been paid at or below the typical dividend level, which is consistent with Commission policy.

In its order in 9401-YO-101 dated June 30, 2004, at page 8, the Commission ordered that all WEC holding company utility affiliates shall get Commission approval for any dividend that exceeds a normal level as long as any tax issues or appeals associated with the transactions to complete the sale of WICOR and conversion of WG to an LLC remain outstanding. A normal dividend is a reasonable level based upon the dividends in the past five years, after giving consideration to the effect any proposed dividend would have on the capital structure. In a letter dated September 18, 2006, to WG, Robert Norcross, Administrator of the Gas and Energy Division, stated, "WGC, LLC may resume its normal dividend in 2006 and continue a normal dividend that would maintain its average regulatory common equity component of capital structure at or above 50.20 percent." In 2006, WG issued a common stock dividend of $27 million. As is shown on page 3 of Appendix D, WG's common stock equity as a percent of

total capitalization as of December 31, 2006, as reported in the 2006 annual report to this Commission was approximately 61.5 percent.[12]

C. Impact on Competition

In past reports the impact on competition has been measured by the number of small business related complaints received. For the 2003 and 2005 period Commission staff is not aware of any small business related complaints filed concerning WEC, WICOR, WEPCO, or WG. Nothing has come to Commission staff's attention that would indicate anticompetitive behavior and therefore a negative impact on competition.

D. Utility Rates

Since the last audit report on WEC in 2004, overall rates of WEPCO's electric utility have increased $423.3 million, including increases of $82.6 million for fuel. The gas utility has seen overall rates increases of $47.3 million. These figures incorporate all ordered rate and fuel changes included in rate orders for the January 2004-April 2007 period. See Appendix C for a breakdown of the changes in rates by rate order and type.

While the utility has experienced increases in rates during the January 2004 through April 2007 period, these increases do not indicate that utility ratepayers have been negatively impacted by the holding company. Rate increases were due to increased fuel and purchased power costs, increased costs due to electric reliability construction, and increased costs of natural gas.

E. Reliability of Service

In evaluating a utility's commitment to reliable service, the Commission looks at numerous areas including the volume of service complaints, levels and effectiveness of maintenance, construction 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

Complaints received by the Commission related to WEPCO and WG are shown in total in Table 2. Breakdowns by category were no longer available for 2002 and are therefore only presented in total.

[12] This reflects an adjustment to eliminate the goodwill recorded for financial purposes upon the acquisition of WICOR, Inc.

Table 2[13]
Complaints Received by Public Service Commission

Year	Total	Disconnections & Other Terminations	Deferred Payments	Obtaining Service	Other Service Related Issues	All Other
2002	2126					
2003	3885	1843	504	287	344	907
2004	4182	2083	932	301	182	684
2005	6874	3747	2082	241	148	656
2006	5086	2642	1304	250	170	720

The majority of the complaints have been related to disconnections and deferred payment agreements as shown in Table 2 above. The disconnection and deferred payment complaints reached an all time high in 2005 and can perhaps be attributed to the economy.

The numbers of service-related complaints were fairly flat and minimal for the 2004 through 2006 period and have decreased from the 2003 level. Other complaints were higher in 2003 due in part to contacts regarding the Early Identification Program.

There were no complaints directly related to these utilities being part of a holding company system or about anti-competitive behavior.

2. Maintenance and Construction Activity

In prior reports, a comparison of maintenance costs between various Wisconsin utilities was provided. As of 2002, all of Wisconsin's major energy utilities are part of a holding company system. With the divestiture of transmission assets to ATC, the transfer of the operation of the nuclear plants to Nuclear Management Company, and the advent of Leased Generation the pot of dollars that can be considered comparable is shrinking. Wisconsin Power and Light Company (WP&L) now leases its corporate headquarters which affects the comparability of general plant maintenance. Excluding general plant maintenance in order to keep the various utilities on similar footing would further erode the pot of maintenance dollars being compared and the resulting comparison would not be meaningful.

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' needs. The Commission's advance plan process required the utilities to file generation, transmission, and energy efficiency plans every two years for Commission approval. 1997 Wisconsin 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.

[13] 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 primary complaints is included on the PSCW website.

Over the years, the Commission has reviewed the utilities' natural gas supply planning activities usually within the context of the rate case proceeding. On November 8, 1996, the Commission issued an order in docket 05-GI-106, which formalized the review process for gas supply planning. Annually, each gas utility must file a comprehensive gas supply plan for Commission approval. The utility subsidiaries seem to have devoted sufficient levels of resources to plan for its energy supply.

Based upon Commission staff's review of these three areas through 2006, it appears the reliability of utility service has not been affected by the formation of WEC.

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 B, F, and G contain general information provided by WEC. Appendix B is a copy of WEC's organization charts as of December 31, 2006. WEC's system can be broken down into utility and nonutility related segments. Referring to the organization chart in Appendix B, the companies in the energy sector are listed in the left column, the nonutility related companies are in the center column, and the gas companies are in the right column.

A breakdown of the assets and employees of each nonutility affiliate in total and located in Wisconsin as of December 31, 2006, is included for reference as Appendix F. Investments are

based on the balance sheets of each company and are not reduced to reflect the ownership interest of WEC. Therefore, it is not appropriate to total this schedule to determine the percentage of assets and employees located in Wisconsin for the WEC system. The chart is useful in demonstrating that the vast majority of investments and employees are located within Wisconsin.

Appendix G contains information from WEC which addresses how the various nonutility affiliates comply with Wis. Stat. § 196.795(7)(a). Based upon a review of the activities of the nonutility subsidiaries of WEC, all major subsidiaries appear to comply with at least one subsection of Wis. Stat. § 196.795(7)(a). However, some subsidiaries of the major nonutility subsidiaries (the international operations of Minergy, for example), if reviewed on a stand-alone basis, would not reasonably be expected to do any of the things specified in Wis. Stat. § 196.795(7)(a).

Legislation Concerns

Wis. Stat. § 196.795 allows public utility holding companies to diversify into nonutility 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 nonutility investments of holding company systems, pursuant to Wis. Stat. § 196.795, to allow "eligible assets" to be excluded from the calculation of nonutility 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 nonutility investments. Therefore, an ambiguity exists between what is allowable under the definition of appropriate nonutility 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, WEC's investments in assets that process waste material, (the international operations of Minergy) as defined in Wis. Stat. § 196.01(9m) are considered "eligible assets" but do not meet the criteria in Wis. Stat. § 196.795(7)(a).

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

As reported in prior audit reports, 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), would resolve the problem.

Audit Report on Wisconsin Energy Corporation 2004-2005

Objectives and Scope of Audit

The overall purpose of the audit of Wisconsin Energy Corporation (WEC) was to review the operations of WEC and various affiliated transactions for compliance with Wis. Stat. § 196.795 and affiliated interest agreements approved by the Commission, to determine that the costs incurred, allocation methods, and the pricing methods being used are reasonable.

A detailed audit of WEC was performed for 2001-2002 as reported in the Audit Report on Wisconsin Energy Corporation – 2003 approved by the Commission on October 7, 2004 (2003 Report). This audit was therefore less detailed and focused primarily on the payroll reporting procedures, transfer pricing policies, and Internal Audit functions.

Commission staff reviewed:

- A sample of affiliated transactions for 2004 and 2005 between Wisconsin Electric Power Company (WEPCO) and its non-utility affiliates.
- Non-utility affiliates for compliance with Wis. Stat. § 196.795(7)(a).
- Filings made in compliance with other statutes and Commission orders.
- A list of audits performed by WEPCO's Internal Audit Department from 2003-2005 and selected audits completed in 2004 and 2005, which were reviewed in detail.
- Fair Market Value (FMV) studies for 2004-2005.
- Officer's timesheets and calendars for selected months in 2006.

Relevant findings from the audit are reported below.

Audit Findings and Recommendations

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

The list of non-utility affiliates provided by WEC, included as Appendix G, includes many companies that are deemed by WEC 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."[1] Congress was found to 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.

Based upon a review of the activities of the nonutility subsidiaries of WEC, all major subsidiaries appear to comply with at least one subsection of Wis. Stat. § 196.795(7)(a). However, the second tier nonutility subsidiaries (the international operations of Minergy, for example), if reviewed on a stand-alone basis, would not reasonably be expected to do any of the things specified in Wis. Stat. § 196.795(7)(a).

Filing Requirements

Wis. Stat. § 196.795(6)(d) requires that information on assets and employees within and outside of Wisconsin be filed annually. All reports for 2004-2006 were filed as required and are available on the PSCW Electronic Filing System. Information from the 2005 and 2006 reports is incorporated into Appendix F.

Wis. Stat. § 196.795(6) requires that no more than ten business days after a holding company forms, organizes, or acquires a nonutility affiliate, the holding company must notify the Commission of certain information regarding the new affiliate. A review of 13 filings from 2004 through September 2006 showed that five were received more that 10 business days after acquisition of new investments, but that none were received more than 34 calendar days (about 20-25 business days) after acquisition. This is an improvement over results noted in the report approved by the Commission in 2002.

The Commission order approved in docket 9402-YO-100[2] requires that specific information concerning the holding company and its affiliates be filed on an annual basis. Beginning with the filing for 2004 most of the required information was filed electronically. For 2005 and 2006 all of the required information has been filed electronically and is available for review on the PSCW Electronic Filing System.[3]

WEPCO has continued to file its 10-year financial forecasts in rate cases as required by the Commission in docket 9402-YO-100. Numerous status reports for Port Washington Generating Station required in docket 05-AE-109, and Elm Road Generating Station required in docket 05-AE-118 have been filed electronically with the Commission. WG filed a list of transactions involving capacity on ANR, Guardian, and Viking pipelines and other reports in compliance with order points in various dockets.[4]

No cases were found where required documents had not been filed.

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

[2] This is the holding company formation order approved by the Commission May 28, 1986.

[3] PSCW reference numbers 71848 and 71849 include the information for 2006. Transactions between the utility affiliates (WEPCO and WG) and their nonutility affiliates are incorporated into the Annual Report to the PSCW. Prior to 2005 this information was provided in special pages attached to the regular report to the PSCW.

[4] Filings for WG before 2005 were not reviewed.

Internal Audits - Prior Audit Follow-up

The prior holding company audit found numerous issues with the internal audit (IA) function, which were summarized as follows:

> The significance of the audit findings is often minimized; as a result the board of directors may not be aware of the severity of the issue or its potential consequences. There are also issues associated with compliance with recommendations and work paper retention.

Commission Staff interviewed the head of We-Energies's[5] internal audit department (IA), who has held her position since August of 2002. Since the last audit, a robust data base has been put into effect to track all of the recommendations made by IA. On a quarterly basis, internal control co-coordinators within the business units are responsible for updating the status of actions to implement audit findings. If implementation is not accomplished by the date provided in response to the audit it would be considered "past due" and a report would be sent to the Chief Executive Officer (CEO) and Chief Financial Officer (CFO).

Copies of audit reports are provided to the head of the business unit or organization being audited and their controller. The CEO, CFO, Controller, Corporate Secretary, audit committee, and outside auditors for WEC also receive copies. The WEC audit committee reviews: IA's annual audit plan, the audits completed compared to the plan, issues found in the audits and implementation of audit recommendations.

IA provided a list of projects completed from 2003 to 2005. Commission staff reviewed the following audits: 2003 Wisconsin Leasing Revenue, 2003 Officer's Expenses, 2004 Corporate Travel and Entertainment Card, 2004 Executive Compensation, 2004 Point Beach Nuclear Plant (PBNP) Review, 2005 Affiliated Transactions, and 2005 BTI Travel Agency Billings. The majority of 2004 and 2005 were spent on the Sarbanes Oxley internal controls requirements which were not reviewed by Staff during this audit.

As a result of the Officer Expense and Corporate Travel and Entertainment Card Review, IA made recommendations to improve documentation of business purpose and to improve internal controls to insure that all employees using the cards have filed statements. The PBNP review had several recommendations regarding improvements to cycle counts and inventory adjustments. All recommendations were accepted and implemented.

Although not reviewed in depth, it appears that improvements have been made that address some of the concerns in the prior audit. Review of the internal audit function will continue to be a necessary part of future holding company audits.

Transfer Pricing

According to Article IV, of the Affiliated Interest Agreement approved by the Commission in docket 05-AU-105, any services or assets provided to the non-utility affiliates (NUA) by the

[5] WEPCO and WG are "doing business as" We-Energies.

utilities will be billed at the fair market value (FMV) or cost, whichever is greater. For those services where the FMV exceeds the utility's cost, a billing mark-up is recorded for the difference. The affiliate provider must make a good faith effort to identify the resources needed to perform a service and to determine the value for the service based on the knowledge of the relevant market for such service. If despite good faith efforts, the affiliate provider is not able to determine the FMV of the product or service, the FMV shall be deemed to be equal to 110 percent of the provider's cost.

The order issued in docket 9402-AE-100 requires the preparation of a market study for the Commission's consideration for each affiliated transaction activity.[6] The annual filing includes a summary of the market price studies conducted by each department of the utility for the services the department provides to the non-utility affiliates. The 2003 Report found that the FMV analysis was insufficient and the company agreed to improve their analysis, using the internet sources available to them as well as other resources.

WEPCO did a much better job of seeking out FMV information in 2005 and 2006. The company provided FMV information for the following departments:[7]

- Administrative Services
- Audit
- Chief Executive Operating Office—Administrative Assistants only
- Corporate Affairs
- Corporate Communications
- Customer Relations
- Environmental
- Electric Operations
- Finance
- Fossil Operations
- Human Resources
- Information Technology
- Office of Energy Options
- Legal
- Commodity Resources
- Supply Chain
- State Regulatory Affairs – some positions

[6] As required in the formation order, costs of conducting the FMV studies were billed to WEC. These costs are retained by WEC and not re-allocated to the utilities. For 2003 through 2006 the following amounts were charged: $2,269.59, $2,963.48, $3,632.22, and $4,980.35.

[7] Audit, Corporate Affairs, Finance, Human Resources, Information Technology and Executive Administration were not reviewed in detail.

The departments utilizing the 10 percent mark-up are:

- Customer Analysis and Planning
- Customer Service
- Executive Administration
- Governmental Affairs
- Gas Operations
- State Regulatory Affairs – some positions

Commission staff encourages the company to continue to pursue options for fair market values for the remaining departments using cost plus 10 percent as a proxy for FMV. Commission staff does not believe that the work done by these departments is so specialized that they cannot be addressed by a FMV study.

Payroll Reporting for Officers

The proper time reporting by Officers' of WEC and its utility and nonutility affiliates has been a concern for many years. This topic has been of concern not only in prior holding company reports, but in rate cases filed by WEPCO and WG before the Commission. Rate case docket 05-UR-102 included testimony by Commission staff and applicants.

Commission Staff reviewed the timesheets and calendars of eight officers of WEC, WEPCO, and WG for three months during 2006. Executive assistants to five of the officers were also interviewed.

A. Payroll Sample Findings

Based on the interviews and reviews of calendars and timesheets, Commission staff found:

1. Time reporting was generally done by the executive assistants based on the calendars, with references to other notes, e-mails or voice messages from the executives or the person who scheduled a particular meeting, as needed.
2. Although the workday is generally assumed to be 8 to 5 most executive assistants indicated that the executives often stayed longer. One assistant did count time worked by one executive outside the normal day while on a plane trip.
3. Only 8 hours per day are recorded for each officer. This is not in compliance with the affiliated interest agreement approved by the Commission in docket 05-AU-105.
4. Personal time off during the day was generally ignored on the basis that executives worked more than 40 hours during the week. There may be a 4-hour standard, after which time is charged off.
5. Extended lunch hours are treated in a variety of ways. Extra time is ignored if personal, charged to We-Energies unless specifically told to charge it to a nonutility, or to WE-System depending on content.
6. Weekend work such as while in transit to a business function is not counted.

7. "Private appointments" are generally not charged off as personal time. If in doubt the default for one executive assistant was to charge the WE-System, another indicated that it might just be for notes she has entered, and a third indicated the numerous uses of this category were probably not for personal purposes but instead used to hide the nature of certain meetings and keep them confidential from the rest of the company.
8. ATC and PTF activities are not differentiated between whether the activities are related to the day-to-day operations of the utility and its interaction with ATC and PTF or whether the activities were related to the ownership of interests in these entities and thus nonutility in nature. All instances Commission staff noted were treated as utility related.
9. Charity or political activities were generally charged to the utilities. According to a data request response, time is or should be charged to We-Energies or to WEC based on whether the officer is representing the utilities or the corporation as a whole. From the timesheets reviewed it appears that charges are generally, if not always, to We-Energies.
10. Jury duty of four days was charged entirely to We-Energies despite the fact that the officer's normal time is not 100 percent utility related.
11. Time spent on nonutility meetings or teleconferences with Northern Borders, Minergy, and Wispark according to the calendars reviewed was not charged to nonutility activities.
12. Timesheets were revised January 1, 2003, to list the categories each officer would be likely to use. For the periods reviewed, few officers used more than four or five of the possible choices.
13. We-Energies appears to be the default unless a nonutility event is designated on the calendar. No direct nonutility time was identified that did not involve a meeting, conference or teleconference. Preparation or analysis time is not apparent.
14. The timesheets indicate that "WEC Corporate costs include time relating to WEC holding company, activities that don't benefit WE-WG or any WEC non utility affiliate."[8]

B. WEC System Allocations

Based on information provided for 2005, 21 officers charged time to more than one organization. Including the allocation of absence time, approximately 83 percent of their time was directly charged to We-Energies, 10 percent went to WEC-System, 6 percent to Edison Sault and nonutility entities, and about 1 percent went to WEC Corporate. About 94 percent of the WEC-System costs are then allocated to We-Energies based on the general allocator. In total about 93 percent of shared officer costs were charged to We-Energies for 2005.

This leaves about 7 percent to manage Edison Sault, the nonutility companies, and to provide corporate oversight to the WEC-System, which serves to reinforce the need to better identify and

[8] WE is the company's internal acronym for WEPCO.

direct charge the appropriate utility or nonutility affiliates. It would also be advisable to reevaluate whether use of the general allocator for WEC-System costs is appropriate.

C. Overheads

The company establishes an overhead rate at the beginning of the year based on budgeted financial data. This rate is then used for billing as described in the affiliated interest agreement and their billings to non-affiliates (including external customers). A periodic review is done to compare the estimated loading rates to the actual rates annually. If the actual overheads calculated exceeded the forecast for the year, a true-up calculation is completed. For 2005, the forecasted overhead rates were in excess of actual, so no true-up was calculated.[9]

Conclusion

The order approving the affiliated interest agreement between WEC, WICOR, Inc, WEPCO, WG, and other nonutility affiliated in the WEC system that was approved by the Commission in docket 05-AU-105 required that Article IX be amended to provide that:

> Each person who is an officer both of a utility affiliate and of one or more of the nonutility affiliates shall keep a daily record of the amount of time devoted to service for each affiliate. In addition to all hours worked, the record shall identify the date the service was performed, each affiliate for which he or she provided such service and the time spent providing the service. An hourly rate for each officer shall be computed, which shall include base pay (vacation and absent time), bonus, benefits and payroll taxes. The sum of the hours spent, from the daily record, for each officer multiplied by the hourly rate shall constitute the cost of the officer's time to be billed to the nonutility affiliate.

WEC and its affiliates are not in compliance with the approved affiliated interest agreement. All hours worked are not recorded and the electronic calendars do not provide adequate information to substitute for the daily record required in the affiliated interest agreement and order.

As indicated in the Payroll Reporting for Officers section above, time that should have been charged to nonutility affiliated has incorrectly been charged to the regulated utilities.

Recommendations

1. Comply with the requirements of the approved affiliated interest agreement in docket 05-AU-105 by using daily logs for each shared officer that accounts for all of the time worked and provides details to accurately track all time spent on nonutility and WEC corporate oversight activities.
2. Better define "WEC Corporate" to provide examples of what should be included. It appears that time spent on oversight of the holding company system, should probably

[9] Based on information provided during the review of the audit findings, the forecasted overhead rates for 2006 were lower than the actual rate and a true-up was recorded for the affiliates.

be coded as WEC Corporate costs. Some may consider oversight to benefit WEPCO, WG, and the nonutility affiliates and therefore may not be charging oversight costs to this classification under the existing definition that this category should "include activities that don't benefit WE-WG or any WEC non utility affiliate."

3. Develop a procedure and definitions to help properly classify time spent on ATC and PTF. For example, work related to the day to day operations of the utility and its interactions with the transmission company and generation facility might be defined as being utility costs, whereas work related to monitoring WEC's financial investments should be tracked and charged as nonutility costs that should not be directly or indirectly charged to the utility.
4. Charitable and political activity expenses, including labor, are generally excluded from the allowable expenses in determining the revenue requirement in rate cases. These costs need to be identified and recorded in a manner that would allow costs that are charged either directly or indirectly to the utilities to be excluded from rates. Establish a policy and appropriate procedures to accomplish this goal.
5. The policy on time for jury duty should be reviewed, and if necessary revised, to provide that jury duty by shared officers or other shared employees be allocated between affiliates in a reasonable manner rather charged fully to the utility(s).
6. The company should continue its efforts to pursue options for fair market values for the remaining departments using cost plus 10 percent as a proxy for FMV.

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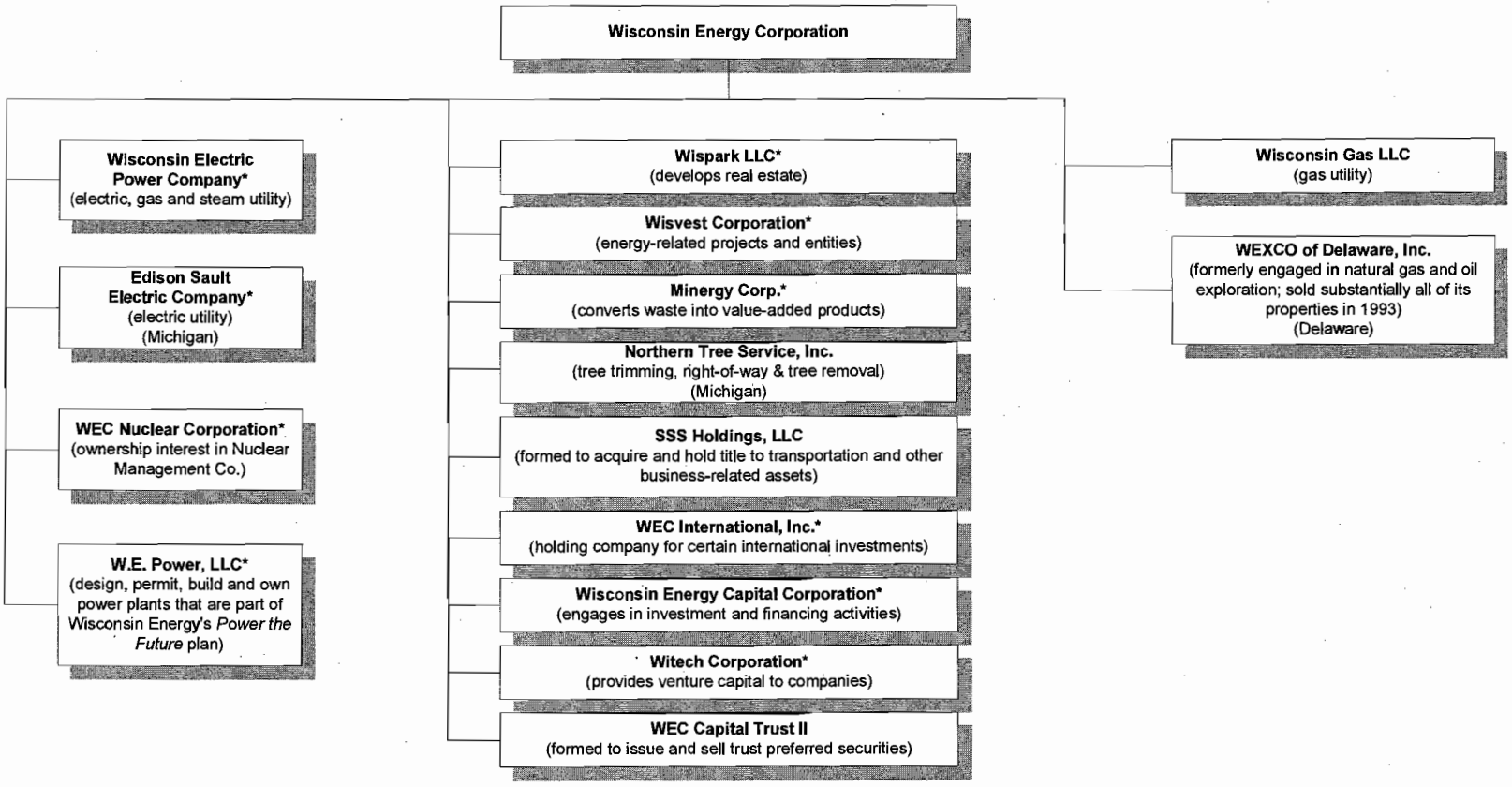

All companies are incorporated in Wisconsin, unless noted.

Wisconsin Electric Power Company and Wisconsin Gas LLC are doing business as We Energies.

*Has subsidiaries or other ownership interests.

Revised: April 28, 2006
Corporate Affairs Dept.

Appendix B

Appendix C

Rate Changes for 2004 through 2006

	(in million's)
Electric Rate Case Increases	
May 2004 (docket 05-UR-101)	$ 59.0
May 2005 (docket 05-UR-101)	$ 59.7
January 2006 (docket 05-UR-102)	$ 222.0
Total Electric Rate Case Increases	$ 340.7
Fuel Changes	
March 2005 (docket 6630-UR-111)	$ 114.9
November 2005 (docket 6630-UR-111)	$ 7.7
October 2006 (docket 6630-FR-100)	$ (30.0)
February 2007 (docket 6630-FR-100) Refund of 2006 fuel costs	$ (10.0)
Total Fuel Case Changes	$ 82.6
Total Rate Changes for Electric	$ 423.3
Natural Gas Rate Case Increases	
March 2004 (docket 05-UR-100)	$ 25.9
January 2006 (docket 05-UR-102)	$ 21.4
Total Rate Changes for Gas	$ 47.3

UR dockets = Utility Rates
FR dockets = Fuel Rates

	12/31/00	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Wisconsin Energy Corporation							
Capitalization:							
Common equity (excludes Goodwill)	1,189,900	1,224,000	1,306,300	1,916,711	2,050,511	2,238,211	2,447,111
Preferred Stock	30,450	30,450	30,450	30,450	30,450	30,450	30,450
Short-term Debt	1,386,100	550,400	953,100	609,900	338,000	456,300	911,900
Long-term Debt	2,606,700	3,552,600	2,888,300	3,741,500	3,340,500	3,527,000	3,370,100
Preferred Securities	200,000	200,000	200,000	-	-	-	-
Off-Balance-Sheet Obligations (OBSO)	42,670	110,762	110,700	216,074	205,241	195,915	179,764
Common Equity Ratio--Booked Basis	21.98%	22.02%	24.29%	30.43%	35.60%	35.80%	36.20%
Total Debt to Capital Ratio	77.46%	77.43%	75.14%	69.09%	63.87%	63.71%	63.35%
Common Equity Ratio-wih OBSO	21.81%	21.59%	23.80%	29.42%	34.38%	34.71%	35.26%
Total Debt to Capital-with OBSO	77.63%	77.87%	75.65%	70.11%	65.11%	64.82%	64.30%
Senior Unsecured							
Moody's Investors Service, Inc.	A2	A2	A2	A3	A3	A3	A3
Standard & Poor's Corp.	A+	A-	A-	BBB+	BBB+	BBB+	BBB+
Fitch	A+	A+	A	A-	A-	A-	A-
WEC Capital Trust Preferred Stock							
Moody's Investors Service, Inc.	A2	A3	A3				
Standard & Poor's Corp.	A-	BBB	BBB				
Fitch	A	A	A-				
Commercial Paper							
Moody's Investors Service, Inc.	P-1	P-1	P-1	P-2	P-2	P-2	P-2
Standard & Poor's Corp.	A-1	A-1	A-2	A-2	A-2	A-2	A-2
Fitch	F1	F1	F1	F2	F2	F2	F2
Security Rating Outlook							
Moody's Investors Service, Inc.							Stable
Standard & Poor's Corp.							Stable
Fitch							Negative

Wisconsin Energy Corporation
Assumes no securitized debt and includes LS Power. Also includes OBSO and an adjustment for unfunded pension and other post-retirement obligations

Actual 2005	Forecast 2006	Forecast 2007	Forecast 2008	Forecast 2009	Forecast 2010	Avg 2006-10
Total Debt to Total Capital--S&P rating						
BB+	BB	BB	BB	BB+	BB	BB+
FFO / Total Debt--S&P rating						
BB+	BB	BB+	BBB	BBB	BBB-	BBB-
FFO Interest Coverage--S&P rating						
BBB+	BBB	BBB	A	A-	A-	BBB+

S&P's rating for WEC unsecured senior debt is BBB+, with a stable outlook

S & P Rating		Adjusted total debt/Total Cap %	Adjusted FFO/Avg Total Debt %	Adjusted FFO Interest Coverage
		BPS = 4 WEC	BPS = 4 WEC	BPS = 4 WEC
AA	Midpt	41.50%	31.50%	4.60
AA-	High	42.67%	30.25%	4.48
AA-	Low	45.00%	27.75%	4.23
A+	High	45.00%	27.75%	4.23
A+	Low	47.33%	25.25%	3.98
A	Midpt	48.50%	24.00%	3.85
A-	High	49.92%	22.67%	3.71
A-	Low	52.75%	20.00%	3.43
BBB+	High	52.75%	20.00%	3.43
BBB+	Low	55.58%	17.33%	3.14
BBB	Midpt	57.00%	16.00%	3.00
BBB-	High	58.33%	15.00%	2.83
BBB-	Low	61.00%	13.00%	2.50
BB+	High	61.00%	13.00%	2.50
BB+	Low	63.67%	11.00%	2.17
BB	Midpt	65.00%	10.00%	2.00

Source: Exhibit EB-3, Schedule 4, Docket 6680-UR-115--Midpoints for AA, A, BBB, and BB ratings.
Other values are interpolations

Wisconsin Electric Power Company
Assumes no securitized debt and no PTF debt. Assumes OBSO and pension and post-retirement liability

Actual 2005	Forecast 2006	Forecast 2007	Forecast 2008	Forecast 2009	Forecast 2010	Avg 2006-10
Total Debt to Total Capital--S&P rating						
BBB+	BBB+	A-	A-	BBB+	BBB+	BBB+
FFO / Total Debt--S&P rating						
BBB	BBB	BBB-	A-	A-	A	BBB+
FFO Interest Coverage--S&P rating						
A+	A	BBB+	AA	AA	AA	AA-

S&P's most recent rating of WEPCO's secured senior debt and its unsecured debt is "A-" with a stable outlook.

S & P Rating		Adjusted total debt/Total Cap %	Adjusted FFO/Avg Total Debt %	Adjusted FFO Interest Coverage
		BPS = 4 WEPCO	BPS = 4 WEPCO	BPS = 4 WEPCO
AA	Midpt	41.50%	31.50%	4.60
AA-	High	42.67%	30.25%	4.48
AA-	Low	45.00%	27.75%	4.23
A+	High	45.00%	27.75%	4.23
A+	Low	47.33%	25.25%	3.98
A	Midpt	48.50%	24.00%	3.85
A-	High	49.92%	22.67%	3.71
A-	Low	52.75%	20.00%	3.43
BBB+	High	52.75%	20.00%	3.43
BBB+	Low	55.58%	17.33%	3.14
BBB	Midpt	57.00%	16.00%	3.00
BBB-	High	58.33%	15.00%	2.83
BBB-	Low	61.00%	13.00%	2.50
BB+	High	61.00%	13.00%	2.50
BB+	Low	63.67%	11.00%	2.17
BB	Midpt	65.00%	10.00%	2.00

Source: Exhibit EB-3, Schedule 4, Docket 6680-UR-115--Midpoints for AA, A, BBB, and BB ratings.
Other values are interpolations

Wisconsin Energy Corporation - 9402
2006 Holding Company Audit

Compiled by
DCB11/20/2007

Nonutility Affiliates (A)	2004 Assets (000) (B) (C) Total	2004 Assets (000) (B) (C) Wisconsin	2004 Employees (E) Total	2004 Employees (E) Wisconsin	2005 Assets (000) (B) (C) Total	2005 Assets (000) (B) (C) Wisconsin	2005 Employees (E) Total	2005 Employees (E) Wisconsin	Changes Assets (000) (B) (C) Total	Changes Assets (000) (B) (C) Wisconsin	Changes Employees (E) Total	Changes Employees (E) Wisconsin
Wisconsin Energy Corporation (D)	3,956,283	3,956,283	23	23	3,943,561	3,943,561	21	21	-12,722	-12,722	-2	-2
Badger Service LLC	116	116							-116	-116	0	0
Minergy Corp.	18,525	18,525	13	13	15,072	15,072	13	13	-3,453	-3,453	0	0
Northern Tree Service, Inc.	488		20	6	494	0	18	7	6	0	-2	1
SSS Holdings, LLC	2,984	2,984			2,591	2,591			-393	-393	0	0
WEC Capital Trust II	-	-							0	0	0	0
WEC International, Inc.	2	2	3	3	9	9	3	3	7	7	0	0
WEC Nuclear Corporation	3,328	3,328	3	3	3,576	3,576	3	3	248	248	0	0
W.E. Power, LLC	463,084	463,084	43	43	790,226	790,226	40	40	327,142	327,142	-3	-3
WEXCO of Delaware, Inc.	7,053	7,053	2	2	7,378	7,378	2	2	325	325	0	0
Wisconsin Energy Capital Corporation	296,604	296,604	4	4	237,827	237,827	4	4	-58,777	-58,777	0	0
WISPARK LLC	115,955	113,766	17	17	97,779	97,779	18	18	-18,176	-15,987	1	1
WISVEST Corporation	85,819	85,819	16	12	11,615	11,615	9	9	-74,204	-74,204	-7	-3
WITECH Corporation	704	704	5	5	1,338	1,338	5	5	634	634	0	0
700 Lake Shore LLC	6,131	6,131	6	6	6,132	6,132	6	6	1	1	0	0
Blue Sky Wind Farm, LLC							2	2	0	0	2	2
Bolingbrook Associates, LLC	10,484								-10,484	0	0	0
Bostco LLC	41,751	41,751	5	5	40,886	40,886	5	5	-865	-865	0	0
Calumet Energy Team, LLC	22,233								-22,233	0	0	0
CET One, LLC	2,420								-2,420	0	0	0
CET Two, LLC	22,233				28	28			-22,205	28	0	0
CET Three, LLC	8,004								-8,004	0	0	0
Delta Group, Inc.	-	-							0	0	0	0
Elm Road Generating Station Supercritical, LLC	-	-	2	2	598,564	598,564	2	2	598,564	598,564	0	0
Elm Road Services, LLC	-	-	2	2	379,839	379,839	2	2	379,839	379,839	0	0
Furniture Holdings, Inc.	31	31	3	3	27	27	3	3	-4	-4	0	0
GlassPack, LLC	1,957	1,957			1,961	1,961			4	4	0	0
Glenbrook Associates of Milwaukee LP	2,355	2,355			2,222	2,222			-133	-133	0	0
Green Field Wind Farm, LLC							2	2	0	0	2	2
Highland Best LLC	12,304	12,304			17,430	17,430			5,126	5,126	0	0
Insulinde/Minergy V.o.f.	-	-							0	0	0	0
Juneau Avenue Partners LLC	21,433	21,433			17,426	17,426			-4,007	-4,007	0	0
Lake Breeze Wind Farm, LLC							1	1	0	0	1	1
LakeView Lodging LLC	9,510	9,510			6,408	6,408			-3,102	-3,102	0	0
Leasehold Capital Corporation	329	329	2	2	5	5	3	3	-324	-324	1	1
Meadowood Apartments Limited Partnership	5,056	5,056			4,810	4,810			-246	-246	0	0
Minergy Detroit, LLC	695	6	2	2	22	22	2	2	-673	16	0	0
Minergy International B.V.	-	-			1				1	0	0	0
Minergy Neenah LLC	24,885	24,885	29	29	17,441	17,441	30	30	-7,444	-7,444	1	1
Neenah Housing Associates of Wisconsin, LLC	2,789	2,789			2,659	2,659			-130	-130	0	0
Port Washington Generating Station, LLC	317,880	317,880	3	3	445,273	445,273	3	3	127,393	127,393	0	0
Riverfront Power LLC	21,868	21,868			21,575	21,575			-293	-293	0	0
Syndesis Development Corporation	655	655	3	3	662	662	3	3	7	7	0	0
5750 CenterPoint Court Venture, LLC					6,874		6	6	6,874	0	6	6
Androscoggin Energy LLC	192,622				146,525				-46,097	0	0	0
Appleton Court Limited Partnership	2,046	2,046			50	50			-1,996	-1,996	0	0
CenterPoint WISPARK Land Company LLC	52,133	52,133	6	6	64,842		6	6	12,709	-52,133	0	0

Appendix F

Wisconsin Energy Corporation - 9402
2006 Holding Company Audit

Compiled by
DCB11/20/2007

Nonutility Affiliates (A)	2004 Assets (000) (B) (C) Total	2004 Assets (000) (B) (C) Wisconsin	2004 Employees (E) Total	2004 Employees (E) Wisconsin	2005 Assets (000) (B) (C) Total	2005 Assets (000) (B) (C) Wisconsin	2005 Employees (E) Total	2005 Employees (E) Wisconsin	Changes Assets (000) (B) (C) Total	Changes Assets (000) (B) (C) Wisconsin	Changes Employees (E) Total	Changes Employees (E) Wisconsin
Clinker, LLC	28	28							-28	-28	0	0
Commerce Power, LLC	797	797			797	797			0	0	0	0
Distribution Vision 2010, LLC	-	-	3	3	463	463	4	4	463	463	1	1
FRED-Germantown Land Development LP	19	19							-19	-19	0	0
Guardian Pipeline, LLC	273,350	273,350	1	1	268,532	268,532	1	1	-4,818	-4,818	0	0
Historic King Place Limited Partnership	2,281	2,281			2,101	2,101			-180	-180	0	0
Housing Equity Fund 1992 Partnership	1,105	1,105			693	693			-412	-412	0	0
LakeView X Venture, LLC					8,569	8,569	6	6	8,569	8,569	6	6
Merrill City Hall Associates LP	818	818			772	772			-46	-46	0	0
MIBP Properties, LLC	166	166							-166	-166	0	0
Microelectronic Modules Corporation	-	-	1	1			1	1	0	0	0	0
Milwaukee West Development Limited Partnership	5,090	5,090			4,794	4,794			-296	-296	0	0
Mound Avenue Associates LLC	5,575	5,575			5,575	5,575			0	0	0	0
Nuclear Management Company, LLC	136,249	136,249	2499	2499	119,252	119,252	2,066	486	-16,997	-16,997	-433	-2,013
Paradise Place Associates Limited Partnership	1,782	1,782			1,709	1,709			-73	-73	0	0
ReGENco, LLC	18,940	18,940	113	110	16,383	16,383	104	101	-2,557	-2,557	-9	-9
Saukville Associates Limited Partnership	1,659	1,659			1,561	1,561			-98	-98	0	0
Switch Power, Inc.	-	-										
Southside Housing Partners I LP	574	574										
Southside Housing Partners II LP	513	513										

(A) - Pursuant to Wisconsin Statute Section 196.795 definition.
(B) - Adjustments per Section 196.795(6m) (b) 2. have not been made for intercompany investments or loans or minority ownership.
(C) - Asset amounts are the best numbers available at the time of this report. Certain affiliates (other than subsidiaries of Wisconsin Energy) have not finalized their balance sheets for 12/31/05 and therefore the asset amounts provided are subject to adjustment.
(D) - Includes investment in Wisconsin Electric Power Company, Wisconsin Gas LLC, Edison Sault Electric Company and nonutility subsidiaries.
(E) - Includes officers, some of whom may hold positions with more than one affiliate.

Wisconsin Energy Corporation
Third Tier Affiliates
December 31, 2006

3rd tier nonutility subsidiaries of WEC	Meets Condition 1	Meets Condition 2	Meets Condition 3	Meets Condition 4
Fetch Marine AS		x		
Gaslight Pointe Associates, LLC	x			
Juneau Avenue Partners LLC	x			

DEFINITIONS:

Condition 1: The nonutility affiliate will or does substantially retain, substantially attract or substantially promote business activity or employment or provides capital to businesses being formed or operating within the wholesale or retail service territory, within or outside of Wisconsin, 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).

Condition 2: The nonutility affiliate will or does increase or promote energy conservation or develops, produces, or sells renewable energy products or equipment.

Condition 3: The nonutility affiliate will or does conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Condition 4: The nonutility affiliate will or does develop or operate commercial or industrial parks in the wholesale or retail service territory of any public utility affiliate.

Wisconsin Energy Corporation
Second Tier Affiliates
December 31, 2006

2nd tier nonutility subsidiaries of WEC	Meets Condition 1	Meets Condition 2	Meets Condition 3	Meets Condition 4
5605 CenterPoint Court Venture, LLC	x			
5705 CenterPoint Court Venture, LLC	x			
5750 CenterPoint Court Venture, LLC	x			
Blue Sky Wind Farm, LLC			x	
Bostco LLC	x			
CenterPoint WISPARK Land Company, LLC				x
CET Two, LLC			x	
Elm Road Generating Station Supercritical, LLC			x	
Elm Road Services, LLC			x	
GlassPack, LLC		x		
Green Field Wind Farm, LLC			x	
Highland Best LLC	x			
Lake Breeze Wind Farm, LLC			x	
LakeView X Venture, LLC	x			
Leasehold Capital Corporation 1)	x			
Minergy GFT, LLC		x		
Minergy Detroit, LLC		x		
Minergy International B.V.		x		
Minergy Marine LLC		x		
Mound Avenue Associates, LLC	x			
Nuclear Management Company, LLC			x	
Port Washington Generating Station, LLC			x	
Riverfront Power LLC	x			
Syndesis Development Corporation 1)	x			
Wisconsin Energy Capital Corporation - other affiliates 2)	x			
WITECH affiliates 3)	x			

NOTES:

1) These affiliates provide a return of and a return on capital to Wispark so that Wispark may in turn pursue its ongoing primary mission of developing commercial and industrial parks in the wholesale or retail service territory of any public utility affiliate.

2) Wisconsin Energy Capital Corporation (WECC) affiliates consist of low income housing partnerships. WECC is satisfying condition 1 by investing in these affiliates.

3) WITECH Corporation satisfies condition 1 by providing capital to their affiliates and in turn promotes business activity or employment within WEC's public utility affiliates' service territory.

Definition of the conditions are listed on page 3.

Wisconsin Energy Corporation
First Tier Affiliates
December 31, 2006

1st tier nonutility subsidiaries of WEC	Meets Condition 1	Meets Condition 2	Meets Condition 3	Meets Condition 4
Distribution Vision 2010, LLC			x	
Minergy Corp.		x		
Northern Tree Service, Inc.			x	
SSS Holdings, LLC	NA (a)	NA (a)	NA (a)	NA (a)
W.E. Power, LLC			x	
WEC Capital Trust II	NA (b)	NA (b)	NA (b)	NA (b)
WEC International, Inc.		x		
WEC Nuclear Corporation			x	
WEXCO of Delaware, Inc.			x	
Wisconsin Energy Capital Corporation	x			
WISPARK LLC				x
WISVEST Corporation			x	
WITECH Corporation	x			

NOTES:

(a) NA - Entity was formed to acquire and hold title to transportation and other business-related assets for common use by Wisconsin Energy Corporation and its affiliates.

(b) N/A - This entity were established primarily for purchasing and/or selling securities or other cash management practices.

Definition of the conditions are listed on page 3.

Appendix H

Relevant Statutes and Sections of Act 79

Impact on Public Utilities – Act 79, Section 1

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.