

**WPPI Energy**

FINANCIAL STATEMENTS

Including Independent Auditors' Report

December 31, 2008 and 2007

# WPPI Energy

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
WPPI Energy

We have audited the accompanying statement of net assets of WPPI Energy as identified in the accompanying table of contents as of December 31, 2008 and 2007, and related statements of revenues, expenses and changes in net assets and statement of cash flows for the years then ended as well as the statement of fiduciary net assets as of December 31, 2008 and 2007 and statement of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of WPPI Energy's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of WPPI Energy as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended as well as the activities of the fiduciary fund as of December 31, 2008 and 2007 and for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in the footnotes, WPPI Energy adopted the provisions of FASB Statement No. 157 – *Fair Value Measurements*, effective January 1, 2008, prospectively, for natural gas and electricity derivative financial instruments that are measured at fair value on a recurring basis.

The Management Discussion and Analysis information and Schedule of Funding Progress enclosed in this report is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Virchow, Krause & Company, LLP*

Madison, Wisconsin  
March 11, 2009

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## **MANAGEMENT DISCUSSION AND ANALYSIS**

## Financial Statement Overview

In this overview, WPPI Energy (f/k/a Wisconsin Public Power Inc.) discusses and analyzes the condensed financial statements for the years ended December 31, 2008 and 2007. The information presented should be read in conjunction with WPPI Energy's financial statements and the accompanying notes.

WPPI Energy follows the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). The financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

WPPI Energy's financial statements include the following. The Statement of Net Assets provides information about the nature and amount of assets and obligations (liabilities) of WPPI Energy as of the end of the year. The Statement of Revenues, Expenses, and Changes in Net Assets reports revenues and expenses for the year. The Statement of Cash Flows reports cash receipts, cash payments, and net changes in cash.

### Significant Events

In 2008, WPPI Energy had three significant non-recurring events that had an impact on the financial statements. The following is a description of these events, and their impact on the Statement of Net Assets and Statement of Revenues, Expenses and Change in Net Assets.

First, on August 27, 2008, WPPI Energy received a \$54.4 million refund from Wisconsin Electric Power Company ("WEPCO") as part of a FERC-approved settlement related to WEPCO's sale of the Point Beach Nuclear Power Plant to Florida Power and Light ("Point Beach Refund"). As part of the settlement, WEPCO returned funds to customers related to (i) excess decommissioning funds and (ii) the net gain realized from the sale. WPPI Energy classified \$34.7 million of the refund as other operating income for the portion of the refund related to return of the excess decommissioning funds. The remaining \$19.7 million of the refund, which represents the gain on the sale, was classified as non-operating revenue.

WPPI Energy's Board of Directors approved uses for the refund designed to provide long-term benefits to all members<sup>1</sup>. Approximately \$7.2 million of the Point Beach Refund was deferred to the Rate Stabilization Fund to help mitigate potential future unexpected power supply costs, while the remainder of the refund resulted in a \$47.2 million increase in net assets in 2008. The Board designated the following proposed uses for these funds to benefit of members to: i) meet future capital calls to maintain WPPI Energy's ownership in the American Transmission Company, LLC ("ATC"), ii) increase liquidity and working capital given the current economic conditions, iii) provide reserves for future capital projects and flexibility regarding the timing of future borrowings and iv) establish a revolving loan program for member energy efficiency, conservation and renewable projects to lower operating costs.

Second, WPPI Energy issued \$227.49 million (par value) in fixed rate bonds on May 20, 2008, the Power Supply System Revenue Bonds, Series 2008 A ("2008 A bonds"). Due to the failure of the auction rate bond markets, WPPI Energy used the proceeds from the 2008 A bonds to refund all of its outstanding auction rate bonds, which totaled \$191.7 million and consisted of the 2003 B, 2003 C and 2005 B bonds. The proceeds of the 2008 A bonds were also used to fund the \$7.8 million fees associated with terminating the floating to fixed interest rate swaps that WPPI Energy had in place as a hedge for the interest rates on the 2003 B, 2003 C and 2005 B bonds. In addition, approximately \$20.2 million of proceeds from the 2008 A bonds were deposited in the construction fund to finance WPPI Energy's share of capital improvements at the Boswell Energy Center Unit 4 ("Boswell 4"). Proceeds were also deposited into the required debt service reserve fund.

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<sup>1</sup> Any reference to members refers to both WPPI Energy Members and Non-Member Purchasers.

Third, WPPI Energy received \$7.4 million in equity ownership in ATC as part of an agreement among ATC's owners to allow for changes to ATC's Operating Agreement ("ATC Settlement"). This increased WPPI Energy's equity ownership in ATC from approximately 5.5% to 6.4% effective January 1, 2008. The ATC Settlement resulted in a \$7.4 million increase in the change in net assets.

In addition to these non-recurring events, construction continues on Elm Road Project located in Oak Creek, Wisconsin. WPPI Energy has an 8.33% ownership interest or approximately 51 MW, in each of the two 615 MW supercritical coal-fired generators being built by Wisconsin Energy Corporation. The first unit is currently targeted to be in-service three months after the guaranteed in-service date of September 29, 2009 and the second unit is targeted to be in-service one month prior to the guaranteed in-service date of September 29, 2010. As of December 31, 2008, \$154.6 million has been spent out of the estimated \$205 million of WPPI Energy's share of the project costs. Bechtel Power Corporation, the contractor constructing the Elm Road Project, has made Force Majeure claims due to weather and labor conditions and a claim based on changes and delays incurred prior to receiving the Final Notice to Proceed in July 2005, that total \$485 million. WPPI Energy's share would be approximately 8.33% or \$40 million of the total claim. These claims are being strongly contested by the owners of the project. Wisconsin Energy Corporation has stated in their Form 8-K filed with the Securities and Exchange Commission on December 29, 2008 that the claims have no merit. WPPI Energy cannot predict the ultimate outcome of these claims.

### Condensed Statement of Net Assets

*(dollars in millions)*

	2008	2007	2006	2008- 2007 Change	2007- 2006 Change
<b>Assets</b>					
Current assets	\$157.7	\$128.6	\$127.6	\$29.1	\$1.0
Noncurrent assets	196.1	180.5	218.7	15.6	-38.2
Deferred costs	33.6	32.1	30.9	1.5	1.2
Capital assets, net	295.8	237.5	182.0	58.3	55.5
Total assets	<u>\$683.2</u>	<u>\$578.7</u>	<u>\$559.2</u>	<u>\$104.5</u>	<u>\$19.5</u>
<b>Liabilities and Net Assets</b>					
Current liabilities	\$47.8	\$46.9	\$34.4	\$0.9	\$12.5
Deferred credits and other liabilities	62.6	55.3	51.7	7.3	3.6
Long-term debt	414.9	381.2	389.0	33.7	-7.8
Total liabilities	<u>525.3</u>	<u>483.4</u>	<u>475.1</u>	<u>41.9</u>	<u>8.3</u>
Net assets	<u>157.9</u>	<u>95.3</u>	<u>84.1</u>	<u>62.6</u>	<u>11.2</u>
Total liabilities and net assets	<u>\$683.2</u>	<u>\$578.7</u>	<u>\$559.2</u>	<u>\$104.5</u>	<u>\$19.5</u>

#### Assets

Total assets of WPPI Energy on December 31, 2008 were \$683.2 million, which is an increase of \$104.5 million compared to 2007. Total assets on December 31, 2007 were \$578.7 million, which is an increase of \$19.5 million compared to 2006. During 2008, the major contributors to the change in total assets were the Point Beach Refund, issuance of the 2008 A bonds, the ATC Settlement, and changes in capital assets. In

2007, the major contributors to the change in total assets were the changes in capital assets and noncurrent assets.

Capital assets increased by \$58.3 million in 2008 and \$55.5 million in 2007 largely as a result of construction work in progress which increased \$59.3 million in 2008 and \$60.0 million in 2007, offset by normal depreciation. The increase in construction work in progress is primarily due to the on-going construction of the Elm Road Project. In 2008, construction work in progress also includes work on capital improvements at Boswell 4 and an addition and remodel of WPPI Energy's office building. As of December 31, 2008, \$2.0 million of the estimated \$6.9 million total cost of the office building project had been incurred. WPPI Energy is using working capital to temporarily finance the office building project and intends to reimburse itself with proceeds from its next bond issuance.

Noncurrent assets increased by \$15.6 million in 2008 and decreased by \$38.2 million in 2007. The main components that impacted the change in noncurrent assets are: i) changes to the construction funds and debt service funds, ii) changes in the investment in ATC and iii) changes in the Renewal and Replacement Fund and Rate Stabilization Fund.

The construction funds and borrowed debt service funds for the Elm Road Project and Boswell 4 capital improvements are split between funds that are anticipated to be needed in the coming year (current assets) and funds needed more than one year into the future (noncurrent assets). Each year funds are reclassified to current assets from noncurrent assets based on the coming year's anticipated construction needs and interest payments. WPPI Energy reclassified \$16.8 million in 2008 and \$54.1 million in 2007 from noncurrent to current assets to meet the upcoming obligations associated with the Elm Road Project and capital improvements at Boswell 4. In both years, these reclassifications lower the amount of funds classified as non-current assets.

In 2008, proceeds from the 2008 A bonds increased the noncurrent assets held in the construction fund, debt service fund and debt service reserve fund by a total of \$14.3 million.

Noncurrent assets also include WPPI Energy's investment in ATC, which continues to increase. In 2008, investment in ATC increased by \$11.5 million due to capital contributions of \$6.7 million, \$2.1 million of earnings retained by ATC, \$7.4 million of equity provided to WPPI Energy as part of the ATC Settlement, less a \$4.7 million refund to WPPI Energy of equity contributed in prior years to ATC as part of the ATC Settlement. In 2007, investment in ATC increased by \$6.5 million due to \$4.5 million in capital contributions by WPPI Energy and \$2.0 million in earnings remaining invested in ATC. WPPI Energy's ownership interest in ATC increased from approximately a 5.5% as of December 31, 2007 to approximately 6.4% as of December 31, 2008 as a result of the ATC Settlement.

An additional impact on noncurrent assets in 2008 and 2007 was additions to the Renewals and Replacements Fund. In 2008, WPPI Energy had a net increase of \$7.8 million in the Renewals and Replacements Fund. In 2008, WPPI Energy contributed \$10.9 million to the Renewals and Replacements Fund, with \$10.4 million for future capital improvements and \$0.5 million related to future long-term maintenance. The contributions were offset by \$3.1 million WPPI Energy used in 2008 primarily for capital projects at Boswell 4. The 2008 balance in the Renewal and Replacements Fund of \$23.2 million is composed of \$16.0 million for capital projects and \$7.2 million for future long-term maintenance projects. In 2007, the net increase in the Renewals and Replacements Fund was \$3.4 million as a result of a \$5.0 million contribution to the fund offset by \$1.6 million of the fund used in 2007 primarily for capital projects at Boswell 4.

Current assets increased by \$29.1 million in 2008 and \$1.0 million in 2007. In 2008, the increase in current assets is the result of a significant portion of the Point Beach Refund remaining in current assets. This increase was offset by less of the construction fund classified as current assets in 2008 compared to 2007.

Deferred Costs increased by \$1.5 million in 2008 and \$1.2 million in 2007. The largest driver in the increase in deferred costs in 2008 was an increase in the unamortized bond issuance costs related to the issuance of the 2008 A bonds. There was also an impact from a regulatory asset associated with the fair market value of hedges WPPI Energy holds and the termination of the interest rate swaps that will be discussed within the Liabilities section.

### **Liabilities**

During 2008 current liabilities increased by \$0.9 million. The major change in 2008 was a \$5.2 million increase in accrued interest resulting from refunding the auction rate bonds by issuing fixed rate bonds. Interest was paid every 7 or 35 days on the auction rate bonds, whereas interest is paid every 6 months on fixed rate bonds. In addition, the increase in the amount of debt outstanding after issuance of the 2008 A bonds increased the amount of accrued interest at the end of 2008. This increase in accrued interest was offset by \$2.7 million less in current maturities of long term debt and \$1.5 million less in other current liabilities. During 2007 current liabilities increased by \$12.5 million primarily due to a \$7.5 million increase in accounts payable related to accrued purchased power expenses and Elm Road Project expenditures, in addition to a \$3.2 million increase in the current maturities of long-term debt.

Deferred costs (assets) and deferred credits and other liabilities (liabilities) are both impacted by the mark-to-market value of the interest rate swaps. WPPI Energy entered into variable-to-fixed interest rate swaps to hedge the variable interest rate bond series 2003 B, 2003 C, and 2005 B (“swaps”). In 2006, WPPI Energy adopted the principles of regulatory asset and liability accounting in accordance with SFAS No. 71 to record the unrealized gains or losses from the annual mark-to-market calculations on interest rate swaps. In 2007, the interest rate swaps had a negative fair value of \$3.9 million which is recorded as a deferred credit. The corresponding regulatory asset is included in deferred costs. The swaps were terminated on April 23, 2008. The termination of the swaps removed the \$3.9 million deferred cost and deferred liabilities from the Statement of Net Assets in 2008.

WPPI Energy follows SFAS No. 133 – Accounting for Derivative Instruments and Hedging Activities for the financial derivatives that WPPI Energy enters into to stabilize the power costs to its members. These financial derivatives consist of futures contracts for natural gas and electricity. WPPI Energy follows SFAS No. 71 principles of regulatory assets and liability accounting to record the unrealized gains or losses from the fair market values of the hedges. As of December 31, 2008 the fair market value of the hedges was a negative \$4.6 million, which resulted in a recording a \$4.6 million liability for the fair market value and an offsetting regulatory asset.

Over time, WPPI Energy has deferred revenues to the Rate Stabilization Fund for the purpose of stabilizing future rates. In 2008, WPPI Energy deferred a net amount of \$6.4 million into the Rate Stabilization Fund, consisting of \$7.2 million deferred from the Point Beach Refund, \$0.4 million collected from a new member, \$1.0 million due to the additional contributions that new members will make in future periods that was accrued in 2008, less \$2.2 million that was utilized during 2008 for replacement energy costs associated with a Boswell 4 generator outage. There were no revenues deferred to the Rate Stabilization Fund in 2007. The provision for the Rate Stabilization Fund was \$42.9 million at the end of 2008.

Long-term debt (net of unamortized premium) increased by \$33.7 million in 2008 due to the 2008 A bond issuance as described earlier offset by the reclassification of long-term debt to current maturities. In 2007, long-term debt decreased by \$7.8 million due to the reclassification of long-term debt to current maturities and amortizations of the premiums and losses on reacquired debt.

### **Change in Net Assets**

The change in net assets was \$62.6 million in 2008. The increase in 2008 is primarily due to the impact of the Point Beach Refund, equity received as part of the ATC Settlement, and additional revenue collected

through WPPI Energy's rates to members which were designed to collect 125% of debt service, and the increase in equity in ATC that is retained in ATC.

The change in net assets was \$11.2 million in 2007. The increase in 2007 is primarily due to additional revenue collected through WPPI Energy's rates to members which were designed to collect 145% of debt service, the increase in equity retained in ATC and other investment income.

**Condensed Statement of Revenues, Expenses, and Changes in Net Assets**  
(dollars in millions)

	2008	2007	2006	2008- 2007 Change	2007- 2006 Change
Operating revenues	\$406.7	\$339.0	\$294.7	\$67.7	\$44.3
Operating expenses	374.1	334.7	272.5	39.4	62.2
Operating income	32.6	4.3	22.2	28.3	-17.9
Nonoperating revenues (expenses)	29.5	0.5	4.1	29.0	-3.6
Future costs to be (refunded) recovered	0.5	6.0	-1.1	-5.5	7.1
Cum effect of change in accounting princip	0.0	0.4	1.2	-0.4	-0.8
Change in net assets	<u>\$62.6</u>	<u>\$11.2</u>	<u>\$26.4</u>	<u>\$51.4</u>	<u>-\$15.2</u>
Beginning year net assets	95.3	84.1	57.7	11.2	26.4
End of year net assets	157.9	95.3	84.1	62.6	11.2

**Operating Revenue**

Total operating revenues in 2008 were \$406.7 million which is a \$67.7 million increase or 20.0% increase from 2007. The increase in total operating revenues was driven by the \$34.7 million portion of the Point Beach Refund classified as operating revenues, a \$19.4 million increase in revenue from sales to members and a \$13.6 million increase in revenue from sales to others.

Total operating revenues in 2007 were \$339.0 million which was a \$44.3 million or 15.0% increase from 2006. The increase in total operating revenues in 2007 was driven by the increase in revenue from sales to members and sales to others, which was offset by a decrease in other income as discussed below.

Revenue from sales to members increased by \$19.4 million or 6.3% in 2008 from 2007 as a result of higher purchased power expenses that were collected from members despite slightly lower megawatt hours sold to members. In 2008, the revenue from sales to members was reduced by \$5.0 million due to the deferral of revenue to the Rate Stabilization Fund as discussed earlier. Revenue from sales to members increased by \$54.8 million or 21.8% in 2007 from 2006 as a result of higher operating expenses, primarily purchased power expenses, that were collected from members and an increase in the megawatt hours sold to members.

Energy sales to members were 5,215,716 MWh in 2008, 5,290,102 MWh in 2007, and 5,024,694 MWh in 2006. Energy sales to members in 2008 decreased 74,386 MWh or 1.4% from 2007. The reduction in sales to members was due to a cooler summer in 2008 compared to 2007 and the impacts of the economic slowdown in 2008. Energy sales to members in 2007 increased by 265,408 MWh or 5.3% from 2006 as a result of new members, weather and load growth. WPPI Energy had two new members in 2007 and six new members in

2006. These new members accounted for 158,416 MWh or approximately 60% of the increase in energy sales to members in 2007 compared to 2006.

Sales to others increased by \$13.6 million or 42.9% in 2008 from 2007 and by \$5.3 million or 19.8% in 2007 from 2006, primarily from increased revenue from energy sales into the Midwest Independent System Operator (MISO) market in both years.

Other income in 2008 was unusually high compared to 2007 due to the \$34.7 million portion of the Point Beach Refund described earlier. Other income in 2006 was unusually high compared to 2007 due to the \$15.4 million in one-time refunds WPPI Energy received related to the sale of the Kewaunee Nuclear Power Plant by Wisconsin Public Service (“WPS”) and Wisconsin Power and Light (“WPL”) and a rate refund from WPL in 2006.

### **Operating Expenses**

Operating expenses were \$374.1 million in 2008, which is a \$39.4 million or 11.8% increase from 2007, and \$334.7 million in 2007, which was a \$62.2 million or 22.8% increase from 2006. In both years, purchased power expenses were the primary reason for the increase in operating expenses.

Purchased power expenses, including transmission expenses, increased by \$39.3 million or 13.6% in 2008 compared to 2007. Purchased power expenses increased in 2008 due to the following factors: the expiration of a 50 MW low cost (below market) contract in April 2007, significant rate increases that became effective in mid-year in 2007 for WPPI Energy’s purchases from WEPCO and WPL, increased renewable energy purchases and an increase in the purchases from WPS. The increase in purchased power expenses in 2008 was offset to a degree by the \$8.6 million refund WPPI Energy received from a WPL FERC rate case.

Purchased power expenses, including transmission expenses, accounted for \$57.4 million of the increase in operating expenses in 2007. Purchased power expenses increased in 2007 due to the following factors: the expiration of a 50 MW low cost (below market) contract in April 2007, significant rate increases that became effective in 2007 for WPPI Energy’s purchases from WEPCO and WPL, increased expenses from the MISO market including increased energy purchases, higher market energy prices and increased uplift expenses, and increased transmission expenses primarily related to higher network service charges from ATC related to the expansion of the ATC system.

Fuel expenses were \$1.5 million, or 9.3% lower in 2008 compared to 2007, primarily due to lower production at the South Fond du Lac Units 1 and 4 (SFDL) as described below. The lower fuel expenses at SFDL was offset to a degree by higher fuel expenses at WPPI Energy’s gas-fired Island Street Peaking Plant (ISPP) as a result of higher natural gas prices in 2008 compared to 2007.

Fuel expenses were \$1.7 million or 11.6% higher in 2007 compared to 2006, primarily as a result of increased generation at ISPP.

Boswell 4 produced 703,730 MWh in 2008, 709,714 MWh in 2007, and 744,197 MWh in 2006. The production at Boswell 4 in 2008 and 2007 was lower than normal due to an eight and a half week outage in 2008 to rewind the generator and a five week unplanned outage in the spring of 2007 to repair a feed water line rupture and replace an overheated coil in the generator. SFDL produced a combined 14,040 MWh in 2008, 29,594 MWh in 2007, and 21,551 MWh in 2006. Production at SFDL was lower in 2008 due to cooler summer weather which resulted in MISO requesting the units to dispatch less often. ISPP produced 36,647 MWh in 2008, 40,663 MWh in 2007, and 24,661 MWh in 2006 due in part to improved reliability of the unit in 2007 and cooler weather in 2008.

Administrative and general expenses were \$2.4 million or 16.5% higher in 2008 compared to 2007. The primary factors accounting for the increase in administrative and general expenses were increased expenses of energy efficiency and conservation programs, a \$1.0 million expense to increase the provision for Self

Insurance due to an increase per occurrence insurance deductible at SFDL and increased fringe benefit expenses. In 2007, administrative and general expenses were \$1.7 million, or 13.1% higher compared to 2006, primarily due to the costs of additional energy conservation programs, growth in number of employees and salary and benefits adjustments.

### **Non-Operating Revenues (Expenses)**

Non-operating revenues in 2008 were \$29.0 million higher than 2007 primarily due to the \$19.7 million portion of the Point Beach Refund classified as non-operating, the \$7.4 million of equity in ATC received from the ATC Settlement and a \$5.0 million net increase due to the impact of the change in fair market value of hedges and interest rate swaps, offset to a degree by lower investment income.

Investment income decreased \$1.7 million, or 16.1% in 2008 compared to 2007, and decreased by \$1.2 million, or 10.3% in 2007 from 2006. The primary reason for the decrease in 2008 and 2007 is WPPI Energy's continued use of funds for construction of the Elm Road project. Lower interest rates on investments in 2008 impacted the interest earnings on the funds, including interest earned on the Point Beach Refund.

Despite an increased equity investment in ATC in 2008, equity earnings in ATC decreased by \$0.9 million or 11.0% in 2008 compared to 2007 due to the change in the ATC Operating Agreement that modified the earnings distribution formula, effective January 1, 2008. Equity earnings in ATC increased \$1.8 million or 27.8% in 2007 from 2006, as a result of WPPI Energy's increased investment in ATC and corresponding increase in ATC's rate base.

Overall, the change in fair market value of WPPI Energy's hedges and interest rate swaps increased non-operating revenues by \$5.0 million in 2008 compared to 2007. There are two components to this change. First, in 2008, WPPI Energy experienced an unrealized loss of \$4.6 million on the fair market value of financial natural gas and electricity contracts that are accounted for under SFAS 133. Prior to 2008, the impact of the fair market value of the financial natural gas and electric contracts was not material to the overall financial statements and was not recorded. Second, in 2008, the termination of the interest rate swaps resulted in an increase of \$3.9 million in the change in the fair value of the interest rate swaps compared to a decrease in the fair market value of the interest rate swaps of \$5.6 million in 2007. This resulted in a \$9.6 million increase in non-operating revenues in 2008 compared to 2007. Since WPPI Energy utilizes SFAS 71 for both the hedges and interest rate swaps, there is an offsetting impact to the future recoverable costs.

In 2007, WPPI Energy experienced an unrealized loss on the interest rate swaps of \$5.6 million in 2007 due to the change in mark-to-market value of the interest rate swaps. This change does not impact WPPI Energy's overall change in net assets because WPPI Energy utilizes SFAS 71 for the mark-to-market gain or losses on the swaps to match the rate making principles that WPPI Energy utilizes.

Interest expense increased by \$0.2 million or 1.4% in 2008 compared to 2007. Interest expenses were higher due to the additional debt resulting from the 2008 A bond issuance, higher interest rates on the 2008 A bonds compared to the interest rate on auction rate bonds and interest rate swaps in 2007, and higher interest rates on the auction rate bonds net of swap payments until the auction rate bonds were refunded and interest rate swaps terminated due to the failure of the auction rate market in 2008.

Allowance for funds used during construction ("AFUDC") represents the cost of debt used to fund the construction of generation assets. AFUDC is presented in the Statement of Revenues, Expenses and Change in Net Assets as a reduction of interest expense. There was an increase in AFUDC associated with the Elm Road Project in 2008 compared to 2007 that offset the increases in interest expenses listed above.

Interest expense decreased by \$2.7 million in 2007 compared to 2006 primarily due to the increase in AFUDC associated with the Elm Road Project.

### **Future Costs to Be (Returned) Recovered**

Future recoverable costs decreased by \$5.5 million in 2008 compared to 2007 primarily due to the \$5.0 million decrease associated with the SFAS 71 treatment from terminating the interest rate swaps in 2008, and the change in the fair market value associated with natural gas and electricity hedges. Future recoverable costs increased by \$7.1 million in 2007 compared to 2006 primarily due to the SFAS 71 treatment of the 2007 mark-to-market loss on the interest rate swaps as described above. WPPI Energy also applies SFAS 71 to depreciation and amortization expenses for assets that are funded with bond proceeds to insure ratepayers are not charged for both depreciation of an asset and principal payments on the bonds issued to acquire the asset in the same year.

### **Cumulative Effect of Changes in Accounting Principles**

In 2008, there were no changes in accounting principles. In 2007, WPPI Energy implemented GASB 45 – Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions and set the beginning other post employment benefits (“OPEB”) liability to zero. Prior to 2007, WPPI Energy had been accruing a liability for OPEB under FASB 106. The 2007 cumulative effect of the changes in accounting principles was \$0.4 million.

### **Contact Information**

This financial report is designed to provide a general overview of WPPI Energy’s finances. Questions or requests for additional information should be addressed to: WPPI Energy, Attn: CFO, 1425 Corporate Center Drive, Sun Prairie, Wisconsin 53590.

**WPPI Energy**  
**Statements of Net Assets**  
**December 31, 2008 and 2007**

	2008	2007
<b>Assets</b>		
Current assets:		
Cash and investments	\$ 65,600,245	\$ 27,537,196
Restricted cash and investments	61,378,741	68,733,527
Receivables:		
Power sales	24,016,404	24,193,517
Other	319,251	448,317
Unrestricted interest	831,566	606,256
Restricted interest	1,263,933	2,976,900
Total receivables	26,431,154	28,224,990
Inventories	3,949,354	3,704,243
Prepayments	318,515	423,560
Total current assets	157,678,009	128,623,516
Noncurrent assets:		
Restricted cash and investments	133,339,824	129,911,572
Investments	386,876	553,868
Investment in ATC	61,259,116	49,785,744
Receivables from members	1,129,236	221,626
Total non-current assets	196,115,052	180,472,810
Deferred costs:		
Unamortized bond issuance costs	7,313,187	5,197,508
Future recoverable costs	21,295,321	21,886,269
Regulatory asset	4,588,238	3,941,135
Other	427,519	1,112,114
Total deferred costs	33,624,265	32,137,026
Capital assets:		
Electric plant and equipment	215,758,889	211,235,558
Accumulated depreciation and amortization	(102,613,975)	(97,037,685)
Electric plant and equipment, net	113,144,914	114,197,873
Land	242,008	242,008
Construction work in progress	182,393,575	123,057,401
Total capital assets	295,780,497	237,497,282
Total assets	\$ 683,197,823	\$ 578,730,634

	<u>2008</u>	<u>2007</u>
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Liabilities payable from restricted assets:		
Current maturities of long-term debt	\$ 6,580,000	\$ 9,325,000
Accrued interest	10,758,613	5,515,800
Accounts payable	30,007,184	30,206,375
Other current liabilities	395,683	1,854,917
Total current liabilities	<u>47,741,480</u>	<u>46,902,092</u>
Deferred credits and other liabilities:		
Operating reserves and other liabilities	12,898,150	12,708,005
Rate stabilization	42,943,546	36,555,985
Fair value of interest rate swap agreement	-	3,941,135
Fair value of hedge agreements	4,588,238	-
Asset Retirement Obligation	2,195,286	2,090,749
Total deferred credits & other liabilities	<u>62,625,220</u>	<u>55,295,874</u>
Long-term debt:		
Revenue bonds (net of unamortized premium)	414,940,797	381,231,881
Total liabilities	525,307,497	483,429,847
Net assets:		
Invested in capital assets, net of related debt	(45,409,497)	(48,866,238)
Restricted	122,964,882	102,626,145
Unrestricted	80,334,941	41,540,880
Total net assets	<u>157,890,326</u>	<u>95,300,787</u>
Total net assets and liabilities	<u>\$ 683,197,823</u>	<u>\$ 578,730,634</u>

**WPPI Energy**  
**Statements of Revenue, Expenses, and Changes in Net Assets**  
**Years Ended December 31, 2008 and 2007**

	2008	2007
<b>Operating revenues:</b>		
Sales to members	\$ 325,850,463	\$ 306,467,820
Sales to others	45,384,928	31,764,755
Other income	35,502,537	805,842
Total operating revenues	406,737,928	339,038,417
<b>Operating expenses:</b>		
Purchased power	328,254,707	288,945,415
Fuel expense	14,803,228	16,328,096
Other power production	4,647,850	5,702,998
Administration and general	17,034,824	14,619,427
Depreciation and amortization	7,059,090	6,778,266
Taxes	2,321,754	2,372,200
Total operating expenses	374,121,453	334,746,402
<b>Operating income</b>	32,616,475	4,292,015
<b>Nonoperating revenues (expenses):</b>		
Investment income	8,801,876	10,495,501
Equity in earnings of ATC	7,467,485	8,391,283
Unrealized (loss) on hedges	(4,588,238)	-
Unrealized (loss) gain on interest rate swap investments	3,941,135	(5,618,188)
Net increase in fair value of investments	215,555	439,849
Gain on equity investment	7,401,333	-
Gain on settlement refund	19,674,403	-
Interest expense	(11,817,481)	(11,656,700)
Amortization of debt-related costs	(1,626,170)	(1,867,865)
Other	-	300,640
Gain (loss) on disposal of assets	(1,027)	366
Total non-operating expenses, net	29,468,871	484,886
Change in net assets before future recoverable costs and cumulative effect of change in accounting principle	62,085,346	4,776,901
Future costs to be (returned) recovered	504,193	5,962,281
Change in net assets before cumulative effect of change in accounting principle	62,589,539	10,739,182
Cumulative effect of change in accounting principle	-	463,007
<b>Change in net assets</b>	62,589,539	11,202,189
Beginning year net assets	95,300,787	84,098,598
End of year net assets	\$ 157,890,326	\$ 95,300,787

**WPPI Energy**  
**Statements of Cash Flows**  
**Years ended December 31, 2008 and 2007**

	2008	2007
<b>Cash flows from operating activities</b>		
Cash receipts from members and others	\$ 412,524,057	\$ 336,481,151
Cash payments for purchased power	(325,455,024)	(282,593,947)
Cash payments for fuel	(15,007,730)	(16,637,488)
Cash payments for operations and maintenance	(3,133,185)	(5,151,753)
Cash payments for payroll and ad valorem taxes	(4,285,497)	(2,286,177)
Cash payments to employees	(6,564,615)	(5,867,417)
Cash payments for administrative and general	(10,556,524)	(6,663,489)
Net cash provided by operating activities	47,521,482	17,280,880
<b>Cash flows from noncapital financing activities</b>		
Cash receipts from outside parties	19,674,403	300,640
<b>Cash flows from investing activities</b>		
Investments purchased	(252,242,917)	(81,115,080)
Investment in ATC	(1,995,570)	(4,453,456)
Investments sold	284,964,154	138,451,563
Investment income	9,477,285	12,130,442
Cash distributions received from ATC	5,391,016	6,328,456
Net cash provided by investing activities	45,593,968	71,341,925
<b>Cash flows from capital &amp; related fin. activities</b>		
Acquisition and construction of capital assets	(58,387,780)	(52,883,406)
Bond issuance costs paid	(4,887,979)	-
Bond premium proceeds	12,141,949	-
Loss on reacquired debt	(8,123,865)	-
Debt Issued	227,490,000	-
Principal paid	(198,950,000)	(6,085,000)
Interest paid	(15,786,565)	(17,853,248)
Net cash used in capital & related fin activities	(46,504,240)	(76,821,654)
<b>Increase in cash and cash equivalents</b>	<b>66,285,613</b>	<b>12,101,791</b>
<b>Cash and cash equivalents, beginning of year</b>	88,933,336	76,831,545
<b>Cash and cash equivalents, end of year</b>	<b>\$ 155,218,949</b>	<b>\$ 88,933,336</b>

	2008	2007
<b>Reconciliation of operating income to net cash flows from operating activities</b>		
Operating income	\$ 32,616,475	\$ 4,292,015
Noncash item included in operating income:		
Depreciation and amortization	7,059,090	6,778,266
Cumulative effect of change in accounting principle	-	463,007
Capitalized taxes	(1,877,741)	-
Changes in assets and liabilities:		
Receivables	(601,432)	(2,538,250)
Inventories	308,366	(137,511)
Prepayments	105,045	644,320
Other deferred charges	684,595	1,005,374
Accounts payable	2,938,621	5,001,937
Other current liabilities	(1,444,996)	1,751,585
Operating reserves and other liabilities	1,345,898	21,472
Rate stabilization	6,387,561	(1,335)
Net cash provided by operating activities	<u>\$ 47,521,482</u>	<u>\$ 17,280,880</u>

**Reconciliation of cash and cash equivalents to the statements of net assets**

Current assets:		
Cash and investments	\$ 65,600,245	\$ 27,537,196
Restricted cash and investments	61,378,741	68,733,527
Noncurrent assets:	-	-
Restricted cash and investments	133,339,824	129,911,572
Investments	386,876	553,868
Total cash and investments	<u>260,705,686</u>	<u>226,736,163</u>
Less: long term investments	105,486,737	137,802,827
Total cash and cash equivalents	<u>\$ 155,218,949</u>	<u>\$ 88,933,336</u>

**Non-Cash Activity:**

During 2008 and 2007 WPPI Energy recognized \$2,412,127 and \$1,678,726 of equity earnings in ATC.  
During 2008 and 2007 WPPI Energy recognized \$105,388 and \$97,654 of accretion of long term investments.  
During 2008 WPPI Energy recognized a \$7,401,333 gain on the ATC investment because of a change in the operating agreement.

**WPPI Energy**  
**WPPI Defined Benefit Plan Trust**  
**Statement of Changes in Fiduciary Net Assets**  
**For the Years Ended December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>
<b>ADDITIONS</b>		
Contributions:		
Employer	\$ 523,313	\$ 881,846
Total contributions	<u>523,313</u>	<u>881,846</u>
Investment earnings:		
Interest	33,711	46,849
Net decrease in the fair value of investments	<u>(269,915)</u>	<u>(3,070)</u>
Total investment earnings	(236,204)	43,779
Less investment expense	<u>6,604</u>	<u>6,075</u>
Total additions	280,505	919,550
<b>DEDUCTIONS</b>		
Benefits	-	-
Total deductions	<u>-</u>	<u>-</u>
Change in net assets	280,505	919,550
Net assets - beginning	<u>919,550</u>	<u>-</u>
Net assets - ending	<u>\$ 1,200,055</u>	<u>\$ 919,550</u>

**WPPI Energy**  
**WPPI Defined Benefit Plan Trust**  
**Statement of Fiduciary Net Assets**  
**December 31, 2008 and 2007**

	2008	2007
<b>ASSETS</b>		
Cash and cash equivalents	\$ 547,990	\$ 271,631
Interest receivable	-	-
Investments, at fair value:		
Certificate of Deposit	93,451	
Mutual funds	558,614	647,919
Total Investments	652,065	647,919
Total assets	\$ 1,200,055	\$ 919,550
<b>LIABILITIES</b>		
Accounts payable	-	-
Total liabilities	-	-
<b>NET ASSETS</b>		
Held in trust for pension benefits	\$ 1,200,055	\$ 919,550

NOTES TO FINANCIAL STATEMENTS

**(1) Summary of Significant Accounting Policies**

**(a) Organization and Operations**

WPPI Energy (f/k/a Wisconsin Public Power Inc.) is a municipal electric company and political subdivision of the State of Wisconsin, formed in 1980. The purpose and function of WPPI Energy is to provide an adequate, economical, and reliable wholesale supply of electricity to its members for distribution by the members' electric utilities to their retail customers. WPPI Energy is owned by its member municipalities, which govern its policies. In addition, WPPI Energy provides wholesale electricity to eight municipal utilities and one electric cooperative located in Michigan and Iowa. While not legal members of WPPI Energy, the non-member purchasers receive service from WPPI Energy under long term power supply contracts ("Long Term Contracts") that are substantially identical to the member's Long Term Contracts. Including Non-Member Purchasers, WPPI Energy served 48 customer-owned electric utilities as of December 31, 2008, with service to a 49<sup>th</sup> and 50<sup>th</sup> commencing January 1, 2009.

WPPI Energy sells power to its members and non-member purchasers under Long Term Contracts that remain in effect until December 31, 2037. Under the contracts, WPPI Energy has agreed to sell and deliver to each member, and each member has agreed to take and pay for its electric power requirements, with certain exceptions related to existing member-owned hydroelectric facilities and other specified generation. WPPI Energy also receives operating revenue from sales of capacity and energy to other entities including sales in the Midwest Independent System Operator (MISO) market.

In addition to its power supply program, WPPI Energy offers various services to members and non-member purchasers that are intended to enable members and non-member purchasers to operate their electric systems more efficiently. The services include rate analyses, rate comparisons, computer network support, large-customer billing, equipment testing, joint purchasing of equipment and supplies, joint arrangements for disposal of hazardous waste, and various energy- and customer-related programs.

WPPI Energy supplies the power requirements of its members and non-member purchasers from a mix of resources, including an undivided 20% ownership in the 535 MW Boswell Unit 4 coal-fired steam unit near Grand Rapids, Minnesota; ownership of two 84 MW combustion turbine units near Fond du Lac, Wisconsin ("South Fond du Lac Units 1 and 4"); ownership of a 54 MW twin pac combustion turbine generator unit in Kaukauna; member generation under contract to WPPI Energy; power purchases from other entities including the MISO energy market and power purchases from various renewable energy projects. Minnesota Power owns the remaining interest in Boswell Unit 4 and is the operating agent responsible for operation and maintenance of the unit. WPPI Energy's undivided ownership interest in Boswell Unit 4 is included in capital assets. WPPI Energy pays 20% of the total cost to operate and maintain Boswell Unit 4. South Fond du Lac Units 1 and 4 are two of the four combustion turbine units located on a site owned by Alliant Energy. Alliant owns the other two units on the site and operates and maintains the units owned by WPPI Energy. WPPI Energy compensates Alliant for these services. Kaukauna Utilities operates and maintains WPPI Energy's 54 MW generator unit, for which it is compensated. The member and non-member purchaser generation under contract to WPPI Energy consists of a number of small generating units, totaling approximately 52 MW of capacity. The remainder of WPPI Energy's power requirements is purchased from other entities.

**(b) *Basis of Presentation/Chart of Accounts***

The financial statements are prepared on the accrual basis of accounting, in conformity with U. S. generally accepted accounting principles, including the application of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effect of Certain Types of Regulation*, as the statement relates to the deferral of revenues and expenses to future periods in which the revenues are earned or the expenses are recovered through the rate-making process. WPPI Energy uses the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC).

WPPI Energy complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, WPPI Energy also complies with the pronouncements of the Financial Accounting Standards Board that do not conflict with GASB pronouncements.

**(c) *Use of Estimates in the Preparation of Financial Statements***

The preparation of financial statements in conformity with U. S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(d) *Capital Assets***

Additions to and replacements of capital assets are recorded at original cost, including allowance for borrowed funds if acquired with tax-exempt debt. Assets with an initial cost greater than \$2,500 and a life greater than two years are capitalized. Depreciation is recorded using the straight-line method using service lives of 2 to 35 years.

**(e) *Deposits and Investments***

Investments of WPPI Energy's funds are restricted by Section 66.0825 of the Wisconsin Statutes which states that notwithstanding the provision of any other law, WPPI Energy may invest in any funds in obligations, securities and other investments that the company deems proper.

**(f) *Restricted Cash and Investments.***

WPPI Energy's bond resolution requires the segregation of bond proceeds and prescribes the application of WPPI Energy's revenues. Amounts classified as restricted cash and investments on the balance sheets represent cash and investments whose use is restricted by the bond resolution.

It is WPPI Energy's practice to use restricted funds on hand for their designated purpose, when available, before using unrestricted funds for such purpose.

**(g) *Unamortized Bond Issuance Costs***

Bond issuance costs are amortized over the repayment period of the related issues using a method that approximates the effective-interest method.

**(h) *Future Costs to be (Returned) Recovered***

Revenues from members include amounts to pay bond principal and interest. For financial reporting purposes, WPPI Energy recognizes depreciation and amortization pertaining to fixed assets and other

assets financed with bond principal. As allowed through the application of the provisions of SFAS No. 71, future recoverable costs represent the difference between depreciation and amortization of assets financed with bond proceeds and the related principal recovered in rates in the present period. These costs will be recovered in future periods when the principal amounts exceed the related depreciation and amortization.

Financial derivatives are recorded under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. WPPI Energy enters into financial derivatives to stabilize power costs to its members, consisting primarily of natural gas futures and electric futures contracts. Unrealized gains and losses from the fair market value of these contracts are recorded under SFAS No. 157, *Fair Value Measurements*. An offsetting regulatory asset or liability is recorded under the SFAS 71, which results in no change in net assets. (See Footnote 11 for more detailed information).

In 2006, WPPI Energy adopted the principles of regulatory asset and liability accounting in accordance with SFAS No. 71 to record the unrealized gains or losses from the annual mark to market calculations on interest rate swaps. The gain or loss on the interest rate swaps is recorded under non-operating revenues (expenses) and the deferral of the gain or loss is recorded under future costs to be (returned) recovered. The deferrals are found on the balance sheet under deferred costs and deferred credits. In 2008, the interest rate swaps were terminated in conjunction with the refunding of WPPI Energy's auction rate bonds.

**(i) Other Deferred Charges**

Other deferred charges primarily represent costs associated with the buyout of WPPI Energy's obligations under a capacity purchase agreement with one of its members. As allowed through the application of SFAS No. 71, such effects have been deferred and are being amortized for rate-making purposes over the original terms of the capacity purchase agreement, which will expire in 2009.

**(j) Cash Equivalents**

For purposes of the statement of cash flows, cash equivalents are cash and investments maturing in three months or less.

**(k) Power Sales Accounts Receivable**

Power Sales accounts receivable, representing power sales to members for the period between the last billing date and the end of the period, are accrued in the period sold.

**(l) Inventories**

Inventories include fuel and repair spare parts. They are charged to plant or operation and maintenance expense at average cost when used. Inventories are valued at the lower of average cost or fair value.

**(m) Rates**

Rates are reviewed and adopted by WPPI Energy's Board of Directors annually. Under WPPI Energy's bond resolution, WPPI Energy's rates are expected to yield net revenues for an annual period equal to at least 1.10 times the aggregate debt service for that period. Rates are not subject to state or federal regulation.

Beginning in 2004, in December of each year the Board of Directors determines how to distribute the margin above 110%. As allowed through the application of the provisions of SFAS No. 71, the margin may be deposited in the Rate Stabilization Fund and is also reported as deferred credits on the accompanying balance sheet to be distributed in future years as revenues in the statement of revenues, expenses, and changes in net assets to cover costs that otherwise would be recovered through rates to members. For the year ended December 31, 2008, \$7,189,485 was deferred, \$410,173 was contributed by a new member, and \$977,388 was accrued for new members. In 2008, \$2,189,485 was used and replenished as a part of the deferral. In 2007, no revenue was deferred, although, \$1,652,000 was used and replenished.

(n) ***Purchased Power***

WPPI Energy has purchased power contracts of varying longer-term duration with a number of suppliers to meet the members' power requirements. WPPI Energy currently purchases a total of approximately 650 MW from Wisconsin Electric Power Company (WEPCO), Wisconsin Power & Light (WPL), Wisconsin Public Service (WPS), and Constellation Energy Commodities Group, Inc. ("Constellation").

***WEPCO – Power Sales Agreement.*** WPPI Energy purchases firm partial requirements service from WEPCO under a Fourth Revised Power Sales Agreement dated May 1, 2007 (the "WEPCO Power Sales Agreement"). The initial term of the WEPCO Power Sales Agreement ends April 30, 2025. WPPI Energy pays FERC approved formula based average embedded cost rates under the WEPCO Power Sales Agreement. WPPI Energy has committed to purchase 250 MW through the contract year beginning June 1, 2008, 230 MW for the contract year beginning June 1, 2009 and 180 MW for the contract year beginning June 1, 2010. Subject to the restriction that WPPI Energy's nomination may only be reduced by a maximum of 50 MW from the prior year's nomination, WPPI Energy is not obligated to purchase a minimum amount of power under the Agreement. WPPI Energy is permitted to schedule energy up to the nominated demand at any time, but is not required to take any energy.

***WEPCO/WPPI Energy First non-Conforming Service Agreement under FERC Electric Tariff Original Volume No. 9 dated September 17, 2008.*** Term is June 1, 2011 through May 31, 2021. Formula rate structure with a 50 MW minimum that can be increased 10 MW per year to a maximum of 100 MW. Once the contract is incremented it cannot be reduced. Hourly energy schedules can be zero and up to the nomination amount but must respect 10 MWh maximum scheduling change.

***WPL – Power Supply Agreement.*** WPPI Energy and WPL entered into a Second Revised Power Supply Agreement ("PSA") on February 4, 2008 that replaced the previous First Revised Power Supply Agreement and the all requirements contracts. The initial term of the Second Revised PSA expires May 31, 2017. Firm partial requirements service purchased under the Second Revised PSA is provided under WPL's partial requirements tariff (PR-1 tariff) filed with FERC. For the contract year commencing on June 1, 2008, WPPI Energy is purchasing a total of 215 MW under the Second Revised PSA. WPPI Energy's nominations are subject to certain minimums and maximums and can change on an annual basis. WPPI Energy nominations can change (up or down) by 25 MW per year. The minimum capacity nomination is 155 MW through May 2014 and then decreases 10 MW per year through May 2017.

***Constellation – Kendall County.*** WPPI Energy purchases, pursuant to the Long-Term Capacity and Energy Purchase Contract with Constellation, approximately 85 MW of capacity and associated energy from the Kendall County Generating Facility Unit 3 ("Kendall County Unit 3"). The Kendall

County Generating Facility (“Facility”) is a 275 MW gas-fired combined-cycle plant located near Joliet, Illinois, which went into service in 2002. The Facility is owned by Dynegy-Kendall LLC, a wholly-owned subsidiary of Dynegy Holdings Incorporated. Constellation has purchased the rights to all of the output of Kendall County Unit 3 through September 16, 2017, at which time the contract terminates.

***WPS Long-Term Power Sale and Purchase Agreement.*** WPPI Energy has a Long-Term Purchase Agreement with WPS that began May 1, 2006. WPPI pays formula based average embedded cost rates under the Agreement. In 2007, WPPI purchased 50 MW from WPS. The purchase increased to 100 MW on June 1, 2008 and will increase to 150 MW on June 1, 2009. The initial term for the 100 MW portion of the contract runs through May 31, 2021 with another 50 MW portion having an initial term running through May 31, 2029. Either party may reduce any of the transactions under the agreement at the end of the initial term or anytime thereafter by giving the other party three years’ notice.

(o) ***Taxes***

WPPI Energy is exempt from Federal, Wisconsin, and Minnesota income taxes as a political subdivision of the State of Wisconsin. Tax expense includes Minnesota property taxes, Wisconsin payments-in-lieu-of-ad valorem taxes, payroll-related taxes, and emission fees.

(p) ***Vacation and Sick Leave***

Under terms of employment, employees are granted one day of sick leave per month. Employees are paid annually for any sick leave accrued in excess of 960 hours. Accrued sick leave is not paid to employees when they leave employment.

Employees are allowed to accumulate up to five days of vacation not taken in the year in which it is earned. Employees are paid annually for any accrued vacation in excess of five days. In extraordinary circumstances, the Senior Vice President of Customer Services and Administration may allow an employee to accumulate additional vacation in excess of five days. Accrued vacation is not considered material; therefore, no liability is recorded.

(q) ***Operating Revenues and Expenses***

Operating revenues result from exchange transactions associated with the principal activity of WPPI Energy, the sale of electricity. Reported operating revenues are affected by the contributions to or distributions from the Rate Stabilization Fund. Operating expenses are defined as expenses directly related to, or incurred in support of, the provision of electricity and other services to the members. All other expenses are classified as nonoperating expenses.

(r) ***Fair Value of Financial Instruments***

The carrying amount of WPPI Energy’s cash and cash equivalents, receivables, and accounts payable approximates fair value because of the short maturities of these instruments. Investments are carried at fair value based on quoted market prices.

(s) ***Operating Reserves and Other Liabilities***

The operating reserves and other liabilities are comprised of the following:

	2008	2007
Self insurance provision	\$ 4,547,946	\$ 3,405,129
Regulatory credit for long-term maintenance	7,178,957	7,339,746
Arbitrage rebate liability	607,034	1,372,507
Other	564,213	590,623
	<u>\$ 12,898,150</u>	<u>\$ 12,708,005</u>

**(t) *New Accounting Pronouncements***

In June of 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits other than Pensions*. This Statement establishes accounting and financial reporting standards for post employment benefits other than pensions. WPPI Energy implemented Statement No. 45 beginning with the year ending December 31, 2007.

In June 2008, the GASB issued Statement No. 53 – *Accounting and Financial Reporting for Derivative Instruments* (GASB 53). GASB 53 addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments and is effective for periods beginning after June 15, 2009. Accordingly, WPPI Energy will adopt GASB 53 during its fiscal year beginning January 1, 2010.

In September 2006, the FASB issued SFAS No. 157 – *Fair Value Measurements* (FASB No. 157). FASB No. 157 provides guidance for using fair value to measure assets and liabilities. The statement clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability. The statement also establishes a fair value hierarchy that prioritizes the information used to develop these assumptions. WPPI Energy implemented Statement No. 157 beginning with the year ending December 31, 2008. Cumulative Effect of Change in Accounting Principle

**(u) *Cumulative Effect of Change in Accounting Principle***

Prior to 2007, WPPI Energy had been accruing a liability for other post employment benefits (OPEB) under FASB 106. In 2007, WPPI Energy implemented GASB 45 and set the beginning OPEB liability to zero. The 2007 cumulative effect of change in accounting principle was \$463,007.

**(2) Deposits and Investments**

WPPI Energy’s bond resolution requires the segregation of bond proceeds and establishment of various funds, and prescribes the application of WPPI Energy’s revenues. Also, it defines what type of securities WPPI Energy may invest in. Funds consist principally of cash, money market funds, repurchase agreements, investments in the Local Government Investment Pool, treasury notes, agencies, treasury strips, and corporate bonds. The fund’s purposes and balances are summarized below.

<b>Fund</b>	<b>Held by</b>	<b>Purpose</b>
Construction	WPPI	To provide for the acquisition and construction of the power supply system.
Debt Service	Trustee	To accumulate principal and interest associated with each bond series.
Debt Service Reserve	Trustee	To establish a reserve equal to half the largest principal and interest payment that would have to be made in any one year during the remaining life of the bonds.
Revenue	WPPI	To accumulate revenues and to provide for the payment of expenses and for disposition of revenues to various funds.
Renewals & Replacements	WPPI	To provide a reserve to be applied to the payment of the costs of renewals, replacements, and repairs to the power supply system.
Self-Insurance	WPPI	To provide a reserve to be applied to the payment of claims and losses arising from hazards and risks to the extent that the insurance required to be maintained does not cover such claims or losses.
Rate Stabilization	WPPI	To accumulate revenues which will be used to reduce rates in a future period.
Decommissioning	WPPI	To accumulate funds to pay for the eventual costs of decommissioning, retirement, or disposal of major facilities.
General Reserve Fund	WPPI	To be used for any lawful purpose of WPPI Energy not otherwise prohibited by the Resolution.

	<u>2008</u>	<u>2007</u>
<b>Current</b>		
<b>Cash and investments</b>		
Petty Cash	\$ 20	\$ 20
Investments	230,000	100,000
Working Capital	65,370,225	27,437,176
Total current	<u>65,600,245</u>	<u>27,537,196</u>
<b>Restricted cash and investments</b>		
Construction Funds	37,337,189	48,892,996
Debt Service Funds	24,041,552	19,840,531
Total current	<u>61,378,741</u>	<u>68,733,527</u>
<b>Total current</b>	126,978,986	96,270,723
<b>Noncurrent</b>		
<b>Restricted investments</b>		
Construction Funds	35,715,133	50,102,857
Debt Service Funds	2,457,972	5,981,870
Debt Service Reserve Funds	22,791,014	16,146,474
Decommissioning	2,863,996	2,591,150
Rate Stabilization Fund	41,711,375	36,256,383
Renewal and Replacement Fund	23,237,535	15,414,453
Self-Insurance Fund	4,562,799	3,418,385
Total noncurrent	<u>133,339,824</u>	<u>129,911,572</u>
<b>Investments</b>	386,876	553,868
<b>Investment in ATC</b>	61,259,116	49,785,744
<b>Total Noncurrent</b>	194,985,816	180,251,184
<b>Total cash and investments</b>	<u><u>\$ 321,964,802</u></u>	<u><u>\$ 276,521,907</u></u>

Investments are stated at fair value, based on quoted market prices. Adjustments necessary to record investments at fair value are recorded in the statements of revenues, expenses, and changes in net assets.

WPPI Energy has an internal investment policy with guidelines to help ensure safety of principal, liquidity, and diversification of its investment portfolio. Generally, investments permitted by the policy within the limits of WPPI Energy's bond resolution include U.S. government obligations, state and local government and corporate obligations rated in either of the three highest whole rating categories by a nationally recognized rating agency, guaranteed investment contracts, or a portfolio of such investments in money market funds or mutual funds, and investments in ATC.

WPPI Energy's investments are potentially subject to various risks, including the following:

- **Custodial credit risk** – The risk that in the event of a failure of the counterparty to an investment transaction (typically a brokerage firm or financial institution), the government would not be able to recover the value of the investment or collateral securities.

Deposits and investments in each bank are insured by the Federal Deposit Insurance Corporation (FDIC) in the amount of \$100,000 for interest-bearing accounts and \$100,000 for non-interest-bearing accounts. On October 3, 2008, the Emergency Economic Stabilization Act of 2008 temporarily increased the FDIC insurance limit from \$100,000 to \$250,000 through December 31, 2009. On October 14, 2008, the FDIC announced the Temporary Liquidity Guarantee Program, which temporarily provides full coverage for non-interest bearing checking deposit accounts at FDIC-insured institutions that agree to participate in the program through December 31, 2009. A second component, the Temporary Liquidity Guarantee Program, provides a temporary guarantee of newly issued senior unsecured debt issued by participating institutions that is issued on before June 30, 2009. Deposits and investments are also insured for \$400,000 by the State Deposit Guarantee Fund (SDGF). However, due to the relatively small size of SDGF in relation to the total deposits covered and other legal implications, recovery of material principal losses of the pool may not be significant to WPPI Energy.

At December 31, 2008 WPPI Energy had \$227,765 in bank balances (no book balances) that were uninsured and uncollateralized deposits. At December 31, 2007 WPPI Energy had \$706,832 in bank balances (\$274,277 in book balances) that were uninsured and uncollateralized deposits. In 2007, WPPI Energy entered into a brokerage agreement with J.P. Morgan Futures to facilitate financial energy transactions through the Intercontinental Exchange. This account is not insured by the FDIC. The balance in the account on December 31, 2008 was \$1,564,207 and the balance in the account on December 31, 2007 was \$250,088. All investments held as of December 31, 2008 and December 31, 2007 were held in trust on behalf of and in WPPI Energy's name and therefore not subject to custodial credit risk.

- **Credit risk** – The risk that an issuer or other counterparty to an investment will not fulfill its obligations. WPPI Energy makes certain investments in Guaranteed Investment Contracts. These investments are unrated. As of December 31, 2008 and December 31, 2007 WPPI Energy's investments were rated as follows:

	Standard & Poor's	Moody's	2008 Amount	2007 Amount
U.S. government and agency securities	AAA	Aaa	\$ 85,804,892	\$ 37,235,386
Money market mutual fund	AAA	Aaa	120,616,400	73,057,588
Corporate Bonds	AAA	Aaa	5,106,427	498,950
Corporate Bonds	AA+	Aa1		525,430
Corporate Bonds	AA	Aa1		499,375
Corporate Bonds	AA	Aa2	2,283,962	
Corporate Bonds	AA	Aa3		500,000
Corporate Bonds	AA-	Aa1		506,882
Corporate Bonds	AA-	Aa3	1,454,903	2,533,854
Corporate Bonds	A+	Aa1	745,253	
Corporate Bonds	A+	Aa2	1,452,534	
Corporate Bonds	A+	Aa3	496,255	
Corporate Bonds	A	Aa3	512,270	492,140
Corporate Bonds	A	A2	2,268,111	
Corporate Bonds	A	A1	1,835,839	
			<u>\$ 222,576,845</u>	<u>\$ 115,849,605</u>

- **Concentration risk** – Investing 5% or more of WPPI Energy’s portfolio in the securities of a single issuer. This disclosure excludes U.S. Government Securities that are explicitly guaranteed by the U.S. government and investments issued or guaranteed by U.S. agencies. WPPI Energy has guaranteed investment contracts (repurchase agreements) with three entities for construction and capitalized interest funds. Although the contracts are with each entity, there are underlying securities supporting each contract.

The following investments exceeded the 5% threshold in 2008 and 2007:

	2008	2007
Citigroup Global Markets Inc. Guaranteed Investment Contract	\$35,384,405	\$68,360,874
JPMorgan Chase Bank N.A. Guaranteed Investment Contract	\$0	\$33,024,165
Morgan Stanley & Co. Guaranteed Investment Contract	n/a	\$8,766,561

- **Interest rate risk** –The risk of potential variability in the fair value of fixed rate investments resulting from changes in interest rates (the longer the period for which an interest rate is fixed, the greater the risk).

As of December 31, 2008, WPPI Energy’s investments were classified by maturity as follows:

	Fair Value	Maturity in Years		
		Less than 1	1-5	Over 5
U.S. government & agency securities	\$ 85,804,892	\$ 59,266,066	\$ 22,645,340	\$ 3,893,486
Money market mutual funds	120,616,400	120,616,400	-	-
Certificate of deposit	230,000	230,000	-	-
Guaranteed investment contracts	37,511,945	33,038,386	4,473,559	-
Corporate bonds	16,155,553	6,610,963	9,544,590	-
Mutual Funds	386,876	-	386,876	-
	<u>\$ 260,705,666</u>	<u>\$ 219,761,815</u>	<u>\$ 37,050,365</u>	<u>\$ 3,893,486</u>

As of December 31, 2007, WPPI Energy's investments were classified by maturity as follows:

	Fair Value	Maturity in Years		
		Less than 1	1-5	Over 5
U.S. government & agency securities	\$ 37,235,386	\$ 7,272,456	\$ 25,014,033	\$ 4,948,897
Money market mutual funds	73,057,588	73,057,588	-	-
Certificate of deposit	330,000	100,000	230,000	-
Guaranteed investment contracts	110,151,601	54,066,873	56,084,728	-
Corporate bonds	5,556,631	2,002,214	3,554,417	-
Mutual Funds	323,868	-	323,868	-
	<u>\$ 226,655,074</u>	<u>\$ 136,499,131</u>	<u>\$ 85,207,046</u>	<u>\$ 4,948,897</u>

### (3) Investment in American Transmission Company

During 2000, WPPI Energy purchased an equity interest in ATC Management Inc. and American Transmission Company LLC (collectively ATC). ATC is a for-profit, transmission only company. It owns, plans, maintains, monitors, and operates electric transmission assets in portions of Wisconsin, Michigan, and Illinois. ATC began operations on January 1, 2001. At December 31, 2008 and 2007, WPPI Energy's equity interest in ATC was approximately 6.4% and 5.5%, respectively. The increase in ownership percentage in 2008 was part of an agreement among the ATC owners that allowed for changes to ATC's Operating Agreement. WPPI Energy's investment in ATC qualifies for the equity method of accounting.

Under the terms of the ownership agreement with ATC, WPPI Energy has the right, but not the obligation, to purchase additional member units in ATC as may from time to time arise in order to maintain its initial percentage interest in ATC, as well as participate in voluntary additional capital calls. At December 31 2008, WPPI Energy had outstanding commitments to fund ATC of approximately \$1,605,879. The amount was paid in January 2009.

Condensed financial data of ATC for 2008 and 2007 follows:

	<u>2008</u>	<u>2007</u>
	(In millions)	(In millions)
Operating statement data:		
Revenues	\$466.6	\$408.0
Operating expenses	-209.0	-198.1
Other income (expenses)	-0.5	0.0
Net interest expense	-69.1	-55.8
Earnings before tax	<u>\$188.0</u>	<u>\$154.1</u>
Balance sheet data:		
Current assets	\$50.8	\$48.3
Noncurrent assets	2,480.0	2,189.0
Total assets	<u>\$2,530.8</u>	<u>\$2,237.3</u>
Current liabilities	\$252.0	\$317.1
Long-term debt	1,109.4	899.1
Other noncurrent liabilities	120.2	108.5
Members' equity	1,049.2	912.6
Total liabilities and members' equity	<u>\$2,530.8</u>	<u>\$2,237.3</u>

**(4) Capital Assets**

Capital asset activity for the years ended December 31, 2008 and 2007 was as follows:

<b>2008</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Retirements</b>	<b>Transfers</b>	<b>Ending Balance</b>
Nondepreciable assets:					
Land	\$ 242,008	\$ -	\$ -	\$ -	\$ 242,008
CWIP	123,057,401	64,643,073	-	(5,306,899)	182,393,575
Total nondepreciable assets	123,299,409	64,643,073	-	(5,306,899)	182,635,583
Depreciable assets:					
Utility Plant	211,235,558	197,594	(981,161)	5,306,899	215,758,889
Total depreciable assets	211,235,558	197,594	(981,161)	5,306,899	215,758,889
Accumulated depreciation and amortization	(97,037,685)	(7,059,090)	1,482,800	-	(102,613,975)
Depreciable assets, net	114,197,873	(6,861,496)	501,638	5,306,899	113,144,914
Capital assets, net	\$237,497,282	\$ 57,781,577	\$ 501,638	\$ -	\$ 295,780,497
<b>2007</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Retirements</b>	<b>Transfers</b>	<b>Ending Balance</b>
Nondepreciable assets:					
Land	\$ 242,008	\$ -	\$ -	\$ -	\$ 242,008
CWIP	63,063,956	62,763,317	-	(2,769,872)	123,057,401
Total nondepreciable assets	63,305,965	62,763,317	-	(2,769,872)	123,299,409
Depreciable assets:					
Utility Plant	210,133,168	323,019	(891,142)	1,670,513	211,235,558
Total depreciable assets	210,133,168	323,019	(891,142)	1,670,513	211,235,558
Accumulated depreciation and amortization	(91,388,605)	(6,778,266)	1,129,186	-	(97,037,685)
Depreciable assets, net	118,744,563	(6,455,247)	238,044	1,670,513	114,197,873
Capital assets, net	\$182,050,528	\$ 56,308,070	\$ 238,044	\$ (1,099,360)	\$ 237,497,282

Construction work in progress on December 31, 2008 and December 31, 2007 consists primarily of the 8.33% interest in two 615 MW supercritical coal-fired generating units under construction in Oak Creek, Wisconsin. Also, in 2008 construction at Boswell and construction of an addition and remodel of WPPI Energy's corporate offices were included in construction work in progress. Capitalized interest included in the cost of the Elm Road project was \$18,942,870 and \$10,139,463 for the years ended December 31, 2008 and 2007, respectively. Capitalized interest included in the cost of the Boswell project was \$408,490 in 2008. The Elm Road and Boswell projects were financed by the proceeds of the Series 2005A, 2005B and 2008 A bond issues.

(5) **Asset Retirement Obligations**

WPPI Energy adopted Statement of Financial Accounting Standards No. 143 – *Accounting for Asset Retirement Obligations* (SFAS 143) in 2003. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 requires an enterprise to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of a tangible long-lived asset. Adoption of this statement in 2003 resulted in an increase in net capital assets of \$576,824, an increase in accrued liabilities of \$263,987 and a change in net assets of \$312,837.

The scope of SFAS 143 includes future asset retirement obligations for the closure of ash ponds and scrubber ponds at the Boswell plant site. WPPI Energy used information from Minnesota Power to estimate the cash flows to determine the obligation.

The following table presents the details of WPPI Energy’s asset retirement obligations.

	2008	2007
<b>Balance 1/1</b>	\$ 2,090,749	\$ 1,991,190
Liabilities Incurred	-	-
Liabilities Settled	-	-
Accretion	104,537	99,559
Cash Flow Revisions	-	-
<b>Balance 12/31</b>	<u>\$ 2,195,286</u>	<u>\$ 2,090,749</u>

(6) **Long-term Debt**

The following Power Supply System Revenue Bonds were issued to finance WPPI Energy’s acquisition and construction of utility plants:

	<u>2008</u>	<u>2007</u>
Revenue bonds:		
2003 Series A 4.00% to 5.25% Due July 1, 2007-2033	\$ 58,735,000	\$ 66,010,000
2003 Series B variable rate bonds Due July 1, 2007-2021	-	64,500,000
2003 Series C variable rate bonds Due July 1, 2007-2023	-	33,275,000
2005 Series A 4.625% to 5.00% Due July 1, 2011 -2037	143,020,000	143,020,000
2005 Series B variable rate bonds Due July 1, 2012-2037	-	93,900,000
2008 Series A 4.00% to 5.25% Due July 1, 2009-2037	227,490,000	-
Total bonds outstanding	<u>429,245,000</u>	<u>400,705,000</u>
Less: Current maturities	(6,580,000)	(9,325,000)
Unamortized discount/premium, net	<u>(7,724,203)</u>	<u>(10,148,119)</u>
	<u>\$ 414,940,797</u>	<u>\$ 381,231,881</u>

The terms outstanding for WPPI Energy's variable rate issues in 2007, including the interest rate swaps discussed in (7) below, are the following:

	Fixed Rate Paid	Var Rate Received	Rate paid to Bondholders
2003 Series B Variable Rate Bonds	3.355%	67% of 1 month LIBOR	35 day auction rate
2003 Series C Variable Rate Bonds	2.805%	67% of 1 month LIBOR	35 day auction rate
2005 Series B Variable Rate Bonds	3.500%	68% of weekly LIBOR	7 day auction rate

All of WPPI Energy's variable rate bonds were refunded in 2008 and the interest rate swaps terminated.

The Power Supply System Revenue Bonds are secured by all funds and revenues of WPPI Energy derived from the ownership and operation of its power supply system.

The unamortized discount/premium, which includes the unamortized difference between the reacquisition price and the net carrying amount of refunded debt issues, is amortized over the terms of the related bond issues using a method that approximates the effective-interest method.

Long-term liability activities for the years ended December 31, 2008 and 2007 were as follows:

<b>Long-term liabilities as of December 31, 2008</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending balance</b>
Long-term revenue bonds	\$ 400,705,000	\$ 227,490,000	\$ (198,950,000)	\$ 429,245,000
Less:				
Current maturities	9,325,000	6,580,000	(9,325,000)	6,580,000
Unamortized discount/premium, net	10,148,119	(1,207,503)	(1,216,413)	7,724,203
Long-term revenue bonds, net	<u>\$ 381,231,881</u>	<u>\$ 222,117,503</u>	<u>\$ (188,408,587)</u>	<u>\$ 414,940,797</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 12,708,005	\$ 1,885,725	\$ (1,695,580)	\$ 12,898,150
Rate stabilization	36,555,985	8,577,046	(2,189,485)	42,943,546
Asset retirement obligation	2,090,749	104,537	-	2,195,286
Fair value of interest rate swap agreements	3,941,135	-	(3,941,135)	-
Fair value of hedges	-	4,588,238	-	4,588,238
Total deferred credits and other liabilities	<u>\$ 55,295,874</u>	<u>\$ 15,155,546</u>	<u>\$ (7,826,200)</u>	<u>\$ 62,625,220</u>
<b>Long-term liabilities as of December 31, 2007</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending balance</b>
Long-term revenue bonds	\$ 406,790,000	\$ -	\$ (6,085,000)	\$ 400,705,000
Less:				
Current maturities	6,085,000	9,325,000	(6,085,000)	9,325,000
Unamortized discount/premium, net	11,680,077	-	(1,531,958)	10,148,119
Long-term revenue bonds, net	<u>\$ 389,024,923</u>	<u>\$ (9,325,000)</u>	<u>\$ 1,531,958</u>	<u>\$ 381,231,881</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 11,484,619	\$ 2,303,811	\$ (1,080,425)	\$ 12,708,005
Rate stabilization	36,557,320	1,652,000	(1,653,335)	36,555,985
Asset retirement obligation	1,991,190	99,559	-	2,090,749
Fair value of interest rate swap agreements	-	3,941,135	-	3,941,135
Regulatory liability	1,677,053	-	(1,677,053)	-
Total deferred credits and other liabilities	<u>\$ 51,710,182</u>	<u>\$ 7,996,505</u>	<u>\$ (4,410,813)</u>	<u>\$ 55,295,874</u>

Debt service payments on the outstanding bonds are as follows:

### Debt Service Payments on Remaining Bonds

Year	Principal	Interest	Total
2009	6,580,000	21,517,225	28,097,225
2010	9,055,000	21,194,588	30,249,588
2011	11,115,000	20,744,013	31,859,013
2012	12,985,000	20,201,013	33,186,013
2013	15,635,000	19,534,650	35,169,650
2014-2018	96,125,000	84,767,206	180,892,206
2019-2023	87,685,000	59,535,519	147,220,519
2024-2028	65,380,000	41,394,869	106,774,869
2029-2033	70,885,000	24,644,313	95,529,313
2034-2037	53,800,000	6,366,488	60,166,488
Total	<u>\$429,245,000</u>	<u>\$319,899,882</u>	<u>\$749,144,882</u>

**(7) Interest Rate Swap Agreement**

During 2005, WPPI Energy entered into an interest rate swap agreement with JP Morgan, and during 2003 WPPI Energy entered into two interest rate swap agreements with Bear Stearns. Interest rate swaps involve the contractual exchange of fixed- and floating-rate interest payment obligations based on a notional principal amount. WPPI Energy entered into the interest rate swap agreements to manage interest rate risk caused by fluctuations in interest rates on WPPI Energy's 2003 B, 2003 C and 2005 B bond issues. On April 23, 2008, in conjunction with refunding WPPI Energy's outstanding auction rate debt associated with the 2003 B, 2003 C and 2005 B bond issues, WPPI Energy terminated all three interest rate swaps at a total cost of \$7,768,000. The termination fees for the interest rate swaps were paid for out of the proceeds of the 2008 A bond issue and the expense amortized over the life of the bond series.

**(8) Available Financing**

During 2006, WPPI Energy entered into a revolving line of credit agreement with JPMorgan Chase Bank, N.A. which permits borrowings of up to \$25,000,000 and expires on April 30, 2009. Interest accrued on the unpaid principal amount outstanding at a rate per annum equal to the applicable British Bankers' Association LIBOR rate for deposits in U.S. dollars plus 90 basis points. At December 31, 2008, there were no outstanding balances on the line of credit. Effective January 16, 2009, WPPI Energy amended and restated the credit agreement with JPMorgan Chase Bank, N.A. to extend the line of credit through January 14, 2011. The new interest rate accrued on the unpaid principal amount outstanding at a rate per annum equal to the applicable British Bankers' Association LIBOR rate for deposits in U.S. dollars plus 150 basis points.

**(9) Significant Members**

On a combined basis, two significant members of WPPI Energy accounted for \$75,822,887 and \$72,398,604 or approximately 20.2% and 21.4% of total sales revenues for the years ended December 31, 2008 and 2007, respectively.

## **(10) Employee Benefits**

### **(a) Retirement Plan**

WPPI Energy has a Simplified Employee Pension - Individual Retirement Account (SEP-IRA) covering all of its employees funded through contributions by WPPI Energy. The total contributions to the plan for the years ended December 31, 2008 and 2007 were \$697,596 and \$651,008, respectively.

### **(b) Retention Plan**

In 1999, WPPI Energy established an initial employee retention plan. In 2007, additional amounts were added to the plan that will extend payments out until 2011. The plan will make payments to specific employees after completing the defined years of continuing employment. Plan benefit expenses of \$153,905 and \$165,984 were accrued during 2008 and 2007, respectively. No additional payment obligations were added to the plan in 2008.

### **(c) Defined Benefit Plan**

On January 1, 2007 WPPI Energy adopted the Defined Benefit Plan of Wisconsin Public Power Inc. It is a single-employer plan where the employer (WPPI Energy) contributes funds to the plan. In addition, a trust was formed to control and manage the plan's assets. WPPI Energy is the plan administrator and does not charge the plan for services.

Senior executives are covered by the plan. Currently, there are two active plan participants and one retired participant.

Participants are 100% vested in their accrued benefit at all times. The contributions accrue monthly interest at 0.5%, except for contributions made in 2008 which shall accrue monthly at 0.2083%. Participants are generally eligible for payment of the accrued benefit on the January 2 following the participant's normal retirement date subject to the provisions for early retirement, disability benefits and death benefits. Benefits are paid in the form of a straight life annuity or an optional form of benefit payment. WPPI Energy's Executive Committee approves changes to the plan and defines the amount of plan contributions.

The plan and amendments to the plan defined the dollar contributions for each participant. An initial deposit of \$625,320 was made to the trust from the retention plan and from 2006 net earnings. Another deposit to the trust of \$256,526 was made from 2007 net earnings. In 2008, a deposit of \$208,260 was made for additional benefits while \$315,053 was deposited to cover investment market losses. Total contributions made to the plan for the years ending December 31, 2008 and 2007 were \$523,313 and \$881,846, respectively.

Financial statements for the WPPI Defined Benefit Trust are found after WPPI Energy's financial statements. Accounting for the defined benefit plan is done on an accrual basis. The trust's fair value of the investments is determined by the published value of the mutual funds on December 31, 2008 and 2007. The measurement date used to determine the pension benefit obligations was December 31, 2008 and 2007. The discount rate and expected return on assets was 5.1% in 2008 and 6.0% in 2007. A thirty year amortization period is used with a level dollar amortization method.

As of December 31, 2008, the most recent actuarial valuation date, the plan was 94.41% funded. The actuarial accrued liability for benefits was \$1,271,152, and the actuarial value of assets was \$1,200,055, resulting in an unfunded actuarial accrued liability (UAAL) of \$71,097. This

information can be found in the WPPI Defined Benefit Trust financial statements and the Schedule of Funding Progress.

The projected unit credit cost method was used for this valuation. The objective under this method is to expense each participant's benefits under the plan as they accrue. The total pension to which each participant is expected to become entitled at retirement is broken down into units, each associated with a year of past or future service. The actuarial liability is calculated at the initial application date and each subsequent measurement date as the present value of benefits credited with respect to service before that date.

The service cost is the actuarial present value of those benefits which are expected to be credited with respect to service during the current year, beginning on the valuation date.

In years following the initial application, a plan amendment may change the amount of projected benefit obligation. The amount of change is a prior service cost, and is to be amortized (recognized) in equal annual installments of principal over the average future service, at date of plan amendment, of plan participants expected to receive benefits.

In years following initial application, gains or losses may arise from the following sources:

- A change in the projected benefit obligation resulting from a change in actuarial assumptions.
- Actual return on assets differing from expected return on assets.
- Difference in the projected benefit obligation at year-end (from expected value) due to other plan experience different from assumed.

The investment policies employ an approach that uses a mix of equity and debt mutual funds to attain a return of at least 6%. The policy states that no more than 50% of the funds shall be invested in any type of equity investments with no more than 15% of the fund in non-domestic equities. The investments are monitored monthly and reallocated quarterly.

The pension plan asset allocations by asset category are shown below.

<u>Asset Category</u>	<u>12/31/2008</u>	<u>12/31/2007</u>
Equity Securities	21.5%	38.9%
Debt Securities	18.4%	31.6%
Real Estate	0.0%	0.0%
Other	60.1%	29.5%
Total	100.0%	100.0%

Pension plan expenses were \$207,372 in 2008 and \$884,077 in 2007. The following table presents the unfunded actuarial accrued liability, the annual required contribution (ARC), and the net pension obligation (NPO).

	2008	2007
<b>Schedule of Funding Progress</b>		
Actuarial Present Value of Total Projected Benefits	\$ 1,271,152	\$ 907,592
Actuarial Value of Assets	1,200,055	919,550
Unfunded Actuarial Accrued Liability	\$ 71,097	\$ (11,958)
Percent Funded	94.41%	101.32%
<b>Determination of Annual Required Contribution</b>		
Normal Cost for Benefits	\$ 208,260	\$ 881,846
Amortization of Unfunded Actuarial Liability	(869)	2,231
Annual Required Contribution (ARC)	\$ 207,391	\$ 884,077
<b>Net Pension Obligation</b>		
Annual Required Contribution (ARC)	\$ 207,391	\$ 884,077
Interest on Net Pension Obligation	134	-
Adjustment to Annual Required Contribution	(153)	-
Contributions Made	(523,313)	(881,846)
Increase in Net Pension Obligation	\$ (315,941)	\$ 2,231
Net Pension Obligation -Beginning of Year	\$ 2,231	\$ -
Net Pension Obligation -End of Year	\$ (313,710)	\$ 2,231

**(d) Post Employment Medical Insurance**

WPPI Energy provides post employment medical insurance benefits. An employee who reaches age 60 and has ten years of service with WPPI Energy qualifies for retiree coverage under WPPI Energy's medical insurance at the retiree's cost. For each full year worked past ten, the employee receives one year of benefit credit. An employee can earn up to a maximum of five years of benefit credits. For each year of benefit credit, WPPI Energy will reimburse the employee for a portion of the cost of medical insurance. Full-time employees qualify for 50% reimbursement and part-time employees will receive a pro rata portion. Upon eligibility for Medicare, full-time employees may be reimbursed up to 100% reimbursement and part-time employees a pro rata portion of the cost of a Medicare supplemental policy. An amendment to the plan provides health insurance premium payments for life for two employees. At December 31, 2008 there were 86 active participants, one retired participant, and \$950 of benefits paid. The plan is unfunded. WPPI Energy is the plan administrator and does not charge the plan for services. WPPI Energy's Executive Committee approves changes to the plan and defines the amount of plan contributions.

Other postemployment benefit (OPEB) expenses were \$159,076 for 2008 and \$148,676 for 2007. WPPI Energy's annual OPEB expense is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The table below shows the components of the annual

OPEB cost for the year, the amount actually contributed to plan, and changes in the net OPEB obligation to the plan.

As of December 31, 2008, the most recent actuarial valuation date, the plan was 0% funded. The actuarial accrued liability for benefits was \$851,733, and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability (UAAL) of \$851,733.

The actuarial valuation dates used to determine the OPEB obligations were December 31, 2008 and 2007. In the actuarial valuation, the projected unit credit actuarial cost method was used. The 2008 actuarial assumptions include a 4.0 percent discount rate and an annual healthcare cost trend rate of 9.5 percent initially, reduced by decrements to an ultimate rate of 4.25 percent after 70 years. The 2007 actuarial assumptions include a 4.5 percent discount rate and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 4 percent after 8 years. A thirty year amortization period is used with a level dollar amortization method.

	<u>2008</u>	<u>2007</u>
Actuarial Accrued Liability	\$ 851,733	\$ 880,180
Present Value of Future Normal Costs	<u>1,094,878</u>	<u>1,330,502</u>
Actuarial Present Value of Total Projected Benefits	\$ 1,946,611	\$ 2,210,682
<b>Schedule of Funded Status</b>		
Actuarial Accrued Liability	\$ 851,733	\$ 880,180
Actuarial Value of Assets	<u>-</u>	<u>-</u>
Unfunded Actuarial Accrued Liability (UAAL)	\$ 851,733	\$ 880,180
Funded Ratio	0.00%	0.00%
Covered Payroll	\$ 6,428,558	\$ 6,224,721
UAAL as a percentage of Covered Payroll	13.25%	14.14%
<b>Determination of Annual Required Contribution</b>		
Normal Cost for Benefits	\$ 107,089	\$ 102,478
Amortization of Unfunded Actuarial Liability	<u>54,031</u>	<u>46,198</u>
Annual Required Contribution (ARC)	\$ 161,120	\$ 148,676
<b>Net OPEB Obligation</b>		
Annual Required Contribution	\$ 161,120	\$ 148,676
Interest on net OPEB obligation	6,690	-
Adjustment to annual required contribution	(8,734)	-
Contributions Made	<u>(950)</u>	<u>-</u>
Increase in net OPEB obligation	\$ 158,126	\$ 148,676
Net OPEB Obligation -Beginning of Year	\$ 148,676	\$ -
Net OPEB Obligation -End of Year	\$ 306,802	\$ 148,676

Actuarial valuations of an ongoing plan involve estimates for the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about rates of interest, future employment, mortality, turnover, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan is understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

**(e) Voluntary Employee Separation Benefits**

In 2007 two voluntary separation agreements were signed by employees. The agreements include payouts in 2008 – 2010. The present value of these payouts is included in the 2007 financial statements in the following administration and general and tax accounts. There were no voluntary separation agreements entered into during 2008.

Salaries	338,821.70
Taxes	8,800.62
SEP-IRA	13,542.48
Health Insurance Benefits	<u>22,373.79</u>
	383,538.59

**(11) Derivative Contracts**

In 2008, WPPI Energy’s derivative contracts were defined under Statement of Financial Accounting Standards No. 133 – *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). All power contracts with the exception of those listed below fall under the normal purchase and sale exception in SFAS 133, or are contracts where WPPI Energy expects to take physical delivery of the power. The natural gas futures contracts and electricity futures contracts described below are used strictly to stabilize the cost to serve WPPI Energy’s load. WPPI Energy does not actively trade natural gas or electric futures contracts but holds until the settlement month. Any realized gains or losses in these futures contracts either increase or decrease purchased power expenses in the contract month. WPPI Energy follows Statement of Financial Accounting Standards No. 71 – *Accounting for the Effects of Certain Regulation* (SFAS 71). A regulatory asset or liability is recorded as an offset to the net fair market value of the contract until the settlement month is reached. Due to the adoption of SFAS 71, WPPI Energy does not elect hedge accounting for its futures contracts. WPPI Energy did not record its derivative contracts in 2007 as defined by SFAS 133 as its derivative activities were not deemed material to the financial statements, taken as a whole, in addition to the exemption options found in SFAS 71. WPPI Energy records all futures contracts at fair value in accordance with Statement on Financial Accounting Standards No. 157 – *Fair Value Measurements* (SFAS 157). As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, WPPI Energy uses various valuation methods including the market, income and cost approaches. The assumptions used in the application of these valuation methods are developed from the perspective of market participants pricing the asset or liability. Inputs used in the valuation methods can be either readily observable, market corroborated, or generally unobservable inputs.

Whenever possible WPPI Energy attempts to utilize valuation methods that maximize the use of observable inputs and minimizes the use of unobservable inputs. Based on the observability of the inputs used in the valuation methods WPPI Energy is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Assets and liabilities measured, reported and/or disclosed at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

All futures contracts which meet the definition of a derivative under SFAS 133 have been valued using Level 1 inputs and are carried at the fair market value at year-end.

In summary the total mark to market (net fair market value) is shown in the table below.

<u>Type of Derivative Contract</u>	<u>Mark-to-Market Adjustment</u>
Natural Gas Contracts	\$ (3,957,130)
Electricity Contracts	(795,756)
Joint Hedging Arrangement	<u>164,648</u>
Net decrease in fair value	<u>\$ (4,588,238)</u>

### **Natural Gas Futures Contracts**

WPPI Energy uses the New York Mercantile Exchange (NYMEX) to enter into natural gas futures contracts as a tool to hedge the cost of natural gas for a purchased power contract where the price under the purchase power contract is determined by the price of natural gas delivered to the Kendall County Unit 3 generating unit. The natural gas futures contracts are also a hedge for the cost of energy purchased to serve WPPI Energy's load. The natural gas futures contracts are purchased through a third party aggregator that allows WPPI Energy to purchase less than a full contract at a time. WPPI Energy cannot actively trade the natural gas futures contracts once purchased by the aggregator and will hold them to the settlement month.

As of December 31, 2008, WPPI Energy futures contracts had a fair market value of -\$3,957,130, covering calendar years 2009 through 2011. Fair market values are determined based on the closing value for the NYMEX futures contracts held by WPPI Energy.

WPPI Energy marks each position to market on a weekly basis for management reporting. For the year ended December 31, 2008, WPPI Energy recorded a realized net loss of \$57,810 as a purchased power expense.

### **Electricity Futures Contracts**

WPPI Energy uses the Intercontinental Exchange (ICE) to enter into futures contracts to purchase and sell electricity at liquid trading hubs, such as the Cinergy Hub. The purchases and sales are entered into to

hedge the cost of purchasing market energy to serve WPPI Energy load or to hedge the sales of excess energy from WPPI Energy resources during the off-peak periods. WPPI Energy does not actively trade the futures contracts and holds them to contract settlement through ICE.

As of December 31, 2008, WPPI Energy futures contracts had a fair market value of -\$795,756 for calendar year 2009. No electricity futures contracts are currently held for periods beyond 2009. Fair market values are determined based on the closing value for the ICE futures contracts held by WPPI Energy.

WPPI Energy marks each position to market on a daily basis for management reporting. For the year ended December 31, 2008, WPPI Energy recorded a realized net loss of \$643,047 on electricity futures contracts, as compared to the settled market price.

#### **Joint Unit Outage Hedging Agreement**

WPPI Energy has entered into a joint unit outage hedging arrangement with another party to help stabilize the cost to each party in the event either incurs a forced outage at a specified generating unit. WPPI Energy has agreed to sell 25 MW of energy to the other party that is settled financially based on the Cinergy Hub price. In the event WPPI Energy incurs a specified unit outage the settlement is not made for the period of the outage, in the event the counterparty incurs a specified unit outage the sale increases to 50 MW. WPPI expects the probability of a forced unit outage is equal for both parties.

As of December 31, 2008, WPPI Energy had January and February positions covered under this agreement for calendar year 2009. The fair market value of \$164,648 assumes a 25 MW sale on each peak day during the months of January and February 2009.

#### **(12) Commitments**

WPPI Energy has various long-term capacity and energy purchase contracts with various power suppliers. Capacity purchases for 2008 and 2007 totaled approximately 733 and 709 MW, respectively. In addition WPPI Energy has capacity and energy purchases from intermittent wind and run of river hydro totaling 85 MW in 2008. WPPI Energy does not own any transmission facilities and takes service for all of its transmission requirements under contracts and tariffs approved by FERC.

WPPI Energy participates in the MISO energy market. MISO may routinely true-up expenses and revenues for up to 105 days. Under special circumstances, MISO has true-up revenue and expenses for as long as 1,554 days. WPPI accrues items that are known at the time of closing, but since there is such a large window of true-ups actual results may differ from the estimates.

During 2005, WPPI Energy entered into a series of agreements that establish WPPI Energy's rights to an 8.33% interest in two 615 megawatt supercritical coal-fired generating units at a site adjacent to WEPCO's Oak Creek Power Plant (the Project). Except under the limited circumstances as specifically provided within the agreements, WPPI Energy may not terminate its participation or withdraw from the Project. Absent these circumstances or events, WPPI Energy's financial obligation for its participation is approximately \$205 million. As of December 31, 2008, WPPI Energy paid approximately \$154.6 million of this commitment, with the remainder expected to be requested through 2010. All outstanding permit litigation has been resolved.

On December 22, 2008, Bechtel Power Corporation ("Bechtel"), the contractor for the Project, submitted claims for schedule and cost relief. Bechtel is constructing the Project under a Turnkey Engineering, Procurement and Construct (EPC) Contract ("Contract"). Bechtel continues to target an in-service date for unit 1 three months beyond the guaranteed Contract date of September 29, 2009, and an in-service date for

unit 2 one month earlier than the guaranteed Contract date of September 29, 2010. However, Bechtel does request schedule relief that would result in six months of relief from liquidated damages beyond the guaranteed Contract date for unit 1 and three months of relief from liquidated damages beyond the guaranteed Contract date for unit 2.

Bechtel has made Force Majeure claims due to weather and labor conditions and a claim based on changes and delays incurred prior to receiving the Final Notice to Proceed in July 2005. The first claim of \$413 million is related to changed weather and labor conditions. The second claim of approximately \$72 million seeks cost and schedule relief for the alleged effects of Elm Road Services, LLC (ERS) directed changes and ERS-caused delays prior to the issuance of the full notice to proceed in July 2005. WPPI Energy's share of the total \$485 million in claims would be approximately 8.33% or \$40 million.

The owners of the Elm Road Project are strongly contesting these claims. Wisconsin Energy Corporation, has stated in its Form 8-K filed with the Securities and Exchange Commission on December 29, 2008 that it believes the Bechtel claims are without merit. WPPI Energy expects these matters to be resolved through the formal dispute resolution process provided for in the Contract, which involves an informal resolution process followed by mediation and then binding arbitration. We are currently unable to predict the ultimate outcome of the claims.

On August 8, 2008, Minnesota Power received a Notice of Violation (NOV) from the United States Environmental Protection Agency (EPA) asserting violation of the New Source Review (NSR) requirements of the Clean Air Act at Boswell Energy Center Units 1-4 and Laskin Energy Center. The NOV also asserts that the Boswell Energy Center Unit 4 Title V permit was violated. (WPPI Energy is a 20% owner of Boswell 4.) The NOV asserts that seven (7) projects undertaken at these coal-fired plants between 1981-2000 should have been reviewed under the NSR requirement. Minnesota Power stated in their Form 8-K filed with the Securities and Exchange Commission on August 29, 2008 that they believe that the projects were in full compliance with the Clean Air Act and NSR.

Minnesota Power is engaging in discussions with the EPA regarding resolution of these matters, but is unable to predict the outcome of these discussions. The resolution could result in civil penalties and the installation of control technology, some of which is already planned or completed for other regulatory requirements. As of this date, WPPI Energy has not been named in the NOV received by Minnesota Power and has not received an NOV directly from the EPA. However, as a 20% owner in Boswell Energy Center Unit 4, WPPI Energy expects to be responsible for a portion of any penalties that may be issued to Minnesota Power in relation to Boswell unit 4 and be responsible for a portion of the costs of installation of control technologies. WPPI Energy is unable to predict the ultimate financial impact or resolution of these matters at this time.

WPPI Energy has purchased power contracts with WEPCO, WPS and WPL that provide WPPI Energy system average cost power under formula rates. The capacity charges for each calendar year are true-up in the following year. The exact timing and mechanics of the true-up varies by purchase. WPPI Energy does not attempt to make an estimate of the true-up under these purchases and will recognize the actual amount of the true-up in the following year.

### **(13) Risk Management**

WPPI Energy is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; workers' compensation; and health care of its employees. The generating plants are covered by insurance, including property and boiler and machinery policies, with deductibles. Deductibles equal \$200,000 per occurrence on Boswell Unit 4, \$2.5 million per occurrence for the South

Fond du Lac units, and \$500,000 per occurrence on the Kaukauna combustion turbine. Other risks are covered through the purchase of commercial insurance, with minimal deductibles. In 2008, the deductible per occurrence for the South Fond du Lac units was increased from \$1.5 million to \$2.5 million. During the past three years there were no settlements exceeding coverage.

WPPI Energy maintains assets in the Self-Insurance Fund described in note 2 to be applied to the payment of claims and losses arising from hazards and risks to the extent that insurance does not cover such claims or losses.

Following is the activity for the self-insurance liability for the years ended December 31, 2008 and 2007.

	<u>2008</u>	<u>2007</u>
Self-insurance liability, beginning of year	\$ 3,405,129	\$ 3,265,793
Additions, representing interest	142,817	139,336
Additions	1,000,000	
Usage		
Self-insurance liability, end of year	<u>\$ 4,547,946</u>	<u>\$ 3,405,129</u>

**Schedule of Funding Progress – Required Supplemental Information**

*Defined Benefit Plan*

Actuarial Valuation Date	Actuarial Value Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability	Funded Ratio	Annual Covered Payroll	Ratio of UAL to Annual Payroll
12/31/06	\$ 625,310	\$ 657,742	\$ 32,422	95.07%	n/a	n/a
12/31/07	\$ 919,550	\$ 907,592	\$ (11,958)	101.32%	n/a	n/a
12/31/08	\$ 1,200,055	\$ 1,271,152	\$ 71,097	94.41%	n/a	n/a

*Other Post Employment Benefits*

Actuarial Valuation Date	Actuarial Value Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability	Funded Ratio	Annual Covered Payroll	Ratio of UAL to Annual Payroll
12/31/07	\$ 0	\$ 880,108	\$ 880,108	0%	n/a	n/a
12/31/08	\$ 0	\$ 851,733	\$ 851,733	0%	n/a	n/a