

MADISON GAS & ELECTRIC CO  
Form 10-Q  
May 03, 2013

**United States**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

*For the quarterly period ended:*

**March 31, 2013**

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

*For the transition period from \_\_\_\_\_ to \_\_\_\_\_*

<b>Commission</b>	<b>Name of Registrant, State of Incorporation, Address</b>	<b>IRS Employer</b>
<b>File No.</b> 000-49965	<b>of Principal Executive Offices, and Telephone No.</b> <b>MGE Energy, Inc.</b>  (a Wisconsin Corporation)  133 South Blair Street  Madison, Wisconsin 53703  (608) 252-7000  www.mgeenergy.com	<b>Identification No.</b> 39-2040501
000-1125	<b>Madison Gas and Electric Company</b>	39-0444025

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(a Wisconsin Corporation)

133 South Blair Street

Madison, Wisconsin 53703

(608) 252-7000

www.mge.com

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) have been subject to such filing requirements for the past 90 days: Yes  No

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web sites, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were required to submit and post such files):

Yes  No

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

	<b>Large Accelerated Filer</b>	<b>Accelerated Filer</b>	<b>Non-accelerated Filer</b>	<b>Smaller Reporting Company</b>
MGE Energy, Inc.	X			
Madison Gas and Electric Company			X	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

MGE Energy, Inc. and Madison Gas and Electric Company: Yes  No

**Number of Shares Outstanding of Each Class of Common Stock as of April 30, 2013**

MGE Energy, Inc.	Common stock, \$1.00 par value, 23,113,638 shares outstanding.
Madison Gas and Electric Company	Common stock, \$1.00 par value, 17,347,894 shares outstanding (all of which are owned beneficially and of record by MGE Energy, Inc.).

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## **PART I. FINANCIAL INFORMATION.**

### **Filing Format**

This combined Form 10-Q is being filed separately by MGE Energy, Inc. (MGE Energy) and Madison Gas and Electric Company (MGE). MGE is a wholly owned subsidiary of MGE Energy and represents a majority of its assets, liabilities, revenues, expenses, and operations. Thus, all information contained in this report relates to, and is filed by, MGE Energy. Information that is specifically identified in this report as relating solely to MGE Energy, such as its financial statements and information relating to its nonregulated business, does not relate to, and is not filed by, MGE. MGE makes no representation as to that information. The terms "we" and "our," as used in this report, refer to MGE Energy and its consolidated subsidiaries, unless otherwise indicated.

### **Forward-Looking Statements**

This report, and other documents filed by MGE Energy and MGE with the Securities and Exchange Commission (SEC) from time to time, contain forward-looking statements that reflect management's current assumptions and estimates regarding future performance and economic conditions especially as they relate to future load growth, revenues, expenses, capital expenditures, financial resources, regulatory matters, and the scope and expense associated with future environmental regulation. These forward-looking statements are made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. Words such as "believe," "expect," "anticipate," "estimate," "could," "should," "intend," and other similar words generally identify forward-looking statements. Both MGE Energy and MGE caution investors that these forward-looking statements are subject to known and unknown risks and uncertainties that may cause actual results to differ materially from those projected, expressed, or implied.

The factors that could cause actual results to differ materially from the forward-looking statements made by a registrant include (a) those factors discussed in the Registrants' 2012 Annual Report on Form 10-K: Item 1A. Risk Factors, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, as updated by Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations in this report, and Item 8. Financial Statements and Supplementary Data Note 18, as updated by Part I, Item 1. Financial Statements Note 8 in this report, and (b) other factors discussed herein and in other filings made by that registrant with the SEC.

Readers are cautioned not to place undue reliance on these forward-looking statements, which apply only as of the date of this report. MGE Energy and MGE undertake no obligation to publicly release any revision to these forward-looking statements to reflect events or circumstances after the date of this report.

**Where to Find More Information**

The public may read and copy any reports or other information that MGE Energy and MGE file with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. These documents also are available to the public from commercial document retrieval services, the website maintained by the SEC at <http://www.sec.gov>, MGE Energy's website at <http://www.mgeenergy.com>, and MGE's website at <http://www.mge.com>. Copies may be obtained from our websites free of charge. Information contained on MGE Energy's and MGE's websites shall not be deemed incorporated into, or to be a part of, this report.



**Definitions, Abbreviations, and Acronyms Used in the Text and Notes of this Report**

Abbreviations, acronyms, and definitions used in the text and notes of this report are defined below.

MGE Energy and Subsidiaries:

CWDC	Central Wisconsin Development Corporation
MAGAEL	MAGAEL, LLC
MGE	Madison Gas and Electric Company
MGE Construct	MGE Construct, LLC
MGE Energy	MGE Energy, Inc.
MGE Power	MGE Power, LLC
MGE Power Elm Road	MGE Power Elm Road, LLC
MGE Power West Campus	MGE Power West Campus, LLC
MGE Transco	MGE Transco Investment, LLC

Other Defined Terms:

AFUDC	Allowance for Funds Used During Construction
ATC	American Transmission Company LLC
BART	Best Available Retrofit Technology
Blount	Blount Station
CAA	Clean Air Act
CAIR	Clean Air Interstate Rule
CAVR	Clean Air Visibility Rule
Codification	Financial Accounting Standards Board Accounting Standards Codification
Columbia	Columbia Energy Center
CSAPR	Cross-State Air Pollution Rule
CWA	Clean Water Act
DNR	Department of Natural Resources
DOE	United States Department of Energy
Dth	Dekatherms, a quantity measure used in respect of natural gas
EGUs	Electric Generating Units
Elm Road Units	Elm Road Generating Station
EPA	United States Environmental Protection Agency
ERISA	Employee Retirement Income Security Act
FASB	Financial Accounting Standards Board
FTR	Financial Transmission Rights
GHG	Greenhouse Gas
HAPs	Hazardous Air Pollutants
heating degree days (HDD)	Measure of the extent to which the average daily temperature is below 65 degrees Fahrenheit, which is considered an indicator of possible increased demand for energy to provide heating
IRS	Internal Revenue Service
kWh	Kilowatt-hour, a measure of electric energy produced
MACT	Maximum Achievable Control Technology

MAP-21	Moving Ahead for Progress in the 21st Century Act
MATs	Mercury and Air Toxics Standards
MISO	Midwest Independent System Operator (a regional transmission organization)
MW	Megawatt, a measure of electric energy generating capacity
MWh	Megawatt-hour, a measure of electric energy produced
NAAQS	National Ambient Air Quality Standards
NGCC	Natural Gas Combined Cycle
NO <sub>2</sub>	Nitrogen Dioxide
NODA	Notices of Data Availability
NOV	Notice of Violation
NO <sub>x</sub>	Nitrogen Oxides
NSPS	New Source Performance Standards
OPRB	Other Postretirement Benefits

PGA	Purchased Gas Adjustment clause, a regulatory mechanism used to reconcile natural gas costs recovered in rates to actual costs
PJM	PJM Interconnection, LLC (a regional transmission organization)
PM	Particulate Matter
PPA	Purchased power agreement
PSCW	Public Service Commission of Wisconsin
PSD	Prevention of Significant Deterioration
RICE	Reciprocating Internal Combustion Engine
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SIP	State Implementation Plan
SO2	Sulfur Dioxide
Stock Plan	Direct Stock Purchase and Dividend Reinvestment Plan of MGE Energy
UW	University of Wisconsin at Madison
VIE	Variable Interest Entity
WCCF	West Campus Cogeneration Facility
WDNR	Wisconsin Department of Natural Resources
Working capital	Current assets less current liabilities
WPDES	Wisconsin Pollutant Discharge Elimination System
WPL	Wisconsin Power and Light Company
WPSC	Wisconsin Public Service Corporation

**Item 1. Financial Statements.****MGE Energy, Inc.****Consolidated Statements of Income (unaudited)***(In thousands, except per-share amounts)*

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Operating Revenues:</b>		
Regulated electric revenues	\$ 93,494	\$ 89,936
Regulated gas revenues	72,467	57,019
Nonregulated revenues	1,276	2,304
<i>Total Operating Revenues</i>	167,237	149,259
<b>Operating Expenses:</b>		
Fuel for electric generation	10,760	8,851
Purchased power	18,205	19,546
Cost of gas sold	44,692	34,845
Other operations and maintenance	41,649	42,949
Depreciation and amortization	9,624	9,624
Other general taxes	4,679	5,000
<i>Total Operating Expenses</i>	129,609	120,815
<b>Operating Income</b>	37,628	28,444
Other income, net	3,309	2,570
Interest expense, net	(4,675)	(5,104)
Income before income taxes	36,262	25,910
Income tax provision	(13,678)	(9,862)
<b>Net Income</b>	\$ 22,584	\$ 16,048
<b>Earnings Per Share of Common Stock</b>		
(basic and diluted)	\$ 0.98	\$ 0.69
Dividends per share of common stock	\$ 0.395	\$ 0.383
<b>Average Shares Outstanding</b>		
(basic and diluted)	23,114	23,114

**MGE Energy, Inc.****Consolidated Statements of Comprehensive Income (unaudited)***(In thousands)*

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
Net Income	\$ 22,584	\$ 16,048
Other comprehensive income, net of tax:		
Unrealized gain on available-for-sale securities, net of tax (\$43 and \$5)	65	7
<b>Comprehensive Income</b>	<b>\$ 22,649</b>	<b>\$ 16,055</b>

*The accompanying notes are an integral part of the above unaudited consolidated financial statements.*

**MGE Energy, Inc.****Consolidated Statements of Cash Flows (unaudited)***(In thousands)*

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Operating Activities:</b>		
Net income	\$ 22,584	\$ 16,048
Items not affecting cash:		
Depreciation and amortization	9,624	9,624
Deferred income taxes	11,294	8,846
Provision for doubtful receivables	743	1,167
Employee benefit plan expenses	3,336	4,682
Equity earnings in ATC	(2,396)	(2,242)
Other items	750	660
Changes in working capital items:		
Decrease in current assets	17,341	12,377
Decrease in current liabilities	(4,590)	(6,631)
Dividend income from ATC	1,807	1,740
Cash contributions to pension and other postretirement plans	(30,764)	(20,789)
Other noncurrent items, net	(1,077)	(746)
<i>Cash Provided by Operating Activities</i>	28,652	24,736
<b>Investing Activities:</b>		
Capital expenditures	(29,164)	(15,467)
Capital contributions to investments	(373)	(355)
Other	(279)	106
<i>Cash Used for Investing Activities</i>	(29,816)	(15,716)
<b>Financing Activities:</b>		
Cash dividends paid on common stock	(9,132)	(8,843)
Repayment of long-term debt	(667)	(667)
Increase in short-term debt	10,500	-
Other	-	(19)
<i>Cash Provided by (Used for) Financing Activities</i>	701	(9,529)
Change in cash and cash equivalents	(463)	(509)
Cash and cash equivalents at beginning of period	46,357	41,169
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 45,894</b>	<b>\$ 40,660</b>
<b>Supplemental disclosures of cash flow information:</b>		
Significant noncash investing activities:		
Accrued capital expenditures	\$ 12,699	\$ 4,674

*The accompanying notes are an integral part of the unaudited consolidated financial statements.*

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**MGE Energy, Inc.****Consolidated Balance Sheets (unaudited)***(In thousands)*

	<b>March 31, 2013</b>	<b>December 31, 2012</b>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 45,894	\$ 46,357
Receivable - margin account	766	1,818
Accounts receivable, less reserves of \$3,914 and \$3,885, respectively	46,864	41,386
Other accounts receivable, less reserves of \$931 and \$931, respectively	5,125	6,746
Unbilled revenues	26,761	28,262
Materials and supplies, at average cost	16,933	16,997
Fossil fuel	7,375	6,367
Stored natural gas, at average cost	2,195	14,980
Prepaid taxes	13,868	19,520
Regulatory assets - current	8,471	10,327
Deferred income taxes - current	14,260	23,483
Other current assets	7,431	6,694
<i>Total Current Assets</i>	195,943	222,937
Regulatory assets	214,496	218,853
Other deferred assets and other	7,222	7,075
<b>Property, Plant, and Equipment:</b>		
Property, plant, and equipment, net	981,325	975,053
Construction work in progress	115,803	98,411
<i>Total Property, Plant, and Equipment</i>	1,097,128	1,073,464
<b>Investments</b>	65,651	64,595
<b>Total Assets</b>	<b>\$ 1,580,440</b>	<b>\$ 1,586,924</b>
<b>LIABILITIES AND CAPITALIZATION</b>		
<b>Current Liabilities:</b>		
Long-term debt due within one year	\$ 3,365	\$ 3,013
Short-term debt	10,500	-
Accounts payable	39,586	43,518
Accrued interest and taxes	4,099	4,296
Accrued payroll related items	7,711	10,063
Derivative liabilities	8,880	9,270
Other current liabilities	10,605	5,637
<i>Total Current Liabilities</i>	84,746	75,797
<b>Other Credits:</b>		
Deferred income taxes	272,511	270,410
Investment tax credit - deferred	1,466	1,520
Regulatory liabilities	22,598	24,538
Accrued pension and other postretirement benefits	133,380	162,835
Derivative liabilities	61,810	63,320



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Other deferred liabilities and other	53,505	50,584
<i>Total Other Credits</i>	545,270	573,207
<b>Capitalization:</b>		
Common shareholders' equity	592,946	579,429
Long-term debt	357,478	358,491
<i>Total Capitalization</i>	950,424	937,920
Commitments and contingencies (see Footnote 8)	-	-
<b>Total Liabilities and Capitalization</b>	<b>\$ 1,580,440</b>	<b>\$ 1,586,924</b>

*The accompanying notes are an integral part of the above unaudited consolidated financial statements.*

**MGE Energy, Inc.****Consolidated Statements of Common Equity (unaudited)**

(In thousands, except per-share amounts)

	Common Stock Shares	Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Total
<b>2012</b>						
Beginning balance - December 31, 2011	23,114	\$ 23,114	\$ 316,268	\$ 211,458	\$ 112	\$ 550,952
Net income				16,048		16,048
Other comprehensive income					7	7
Common stock dividends declared (\$0.383 per share)				(8,843)		(8,843)
Ending balance - March 31, 2012	23,114	\$ 23,114	\$ 316,268	\$ 218,663	\$ 119	\$ 558,164
<b>2013</b>						
Beginning balance - December 31, 2012	23,114	\$ 23,114	\$ 316,268	\$ 239,953	\$ 94	\$ 579,429
Net income				22,584		22,584
Other comprehensive income					65	65
Common stock dividends declared (\$0.395 per share)				(9,132)		(9,132)
Ending balance - March 31, 2013	23,114	\$ 23,114	\$ 316,268	\$ 253,405	\$ 159	\$ 592,946

*The accompanying notes are an integral part of the above unaudited consolidated financial statements.*

**Madison Gas and Electric Company****Consolidated Statements of Income (unaudited)***(In thousands)*

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Operating Revenues:</b>		
Regulated electric revenues	\$ 93,494	\$ 89,936
Regulated gas revenues	72,467	57,019
Nonregulated revenues	1,276	2,304
<i>Total Operating Revenues</i>	167,237	149,259
<b>Operating Expenses:</b>		
Fuel for electric generation	10,760	8,851
Purchased power	18,205	19,546
Cost of gas sold	44,692	34,845
Other operations and maintenance	41,504	42,528
Depreciation and amortization	9,624	9,624
Other general taxes	4,679	5,000
Income tax provision	12,870	8,969
<i>Total Operating Expenses</i>	142,334	129,363
<b>Operating Income</b>	24,903	19,896
<b>Other Income and Deductions:</b>		
AFUDC - equity funds	596	154
Equity in earnings in ATC	2,396	2,242
Income tax provision	(781)	(993)
Other income, net	141	56
<i>Total Other Income and Deductions</i>	2,352	1,459
Income before interest expense	27,255	21,355
<b>Interest Expense:</b>		
Interest on long-term debt	4,928	5,197
Other interest, net	(37)	7
AFUDC - borrowed funds	(196)	(63)
<i>Net Interest Expense</i>	4,695	5,141
<b>Net Income</b>	\$ 22,560	\$ 16,214
Less Net Income Attributable to Noncontrolling Interest, net of tax	(6,826)	(6,072)
<b>Net Income Attributable to MGE</b>	\$ 15,734	\$ 10,142

**Madison Gas and Electric Company**

**Consolidated Statements of Comprehensive Income (unaudited)***(In thousands)*

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Net Income	\$ 22,560	\$ 16,214
Other comprehensive income (loss), net of tax:		
Unrealized gain (loss) on available-for-sale securities, net of tax (\$18 and \$11)	27	(16)
<b>Comprehensive Income</b>	<b>\$ 22,587</b>	<b>\$ 16,198</b>
Less: Comprehensive income attributable to Noncontrolling Interest, net of tax	(6,826)	(6,072)
<b>Comprehensive Income attributable to MGE</b>	<b>\$ 15,761</b>	<b>\$ 10,126</b>

*The accompanying notes are an integral part of the above unaudited consolidated financial statements.*

**Madison Gas and Electric Company****Consolidated Statements of Cash Flows (unaudited)***(In thousands)*

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Operating Activities:</b>		
Net income	\$ 22,560	\$ 16,214
Items not affecting cash:		
Depreciation and amortization	9,624	9,624
Deferred income taxes	11,016	8,768
Provision for doubtful receivables	743	1,005
Employee benefit plan expenses	3,336	4,682
Equity earnings in ATC	(2,396)	(2,242)
Other items	882	792
Changes in working capital items:		
Decrease in current assets	17,135	11,542
Decrease in current liabilities	(4,326)	(6,991)
Dividend income from ATC	1,807	1,740
Cash contributions to pension and other postretirement plans	(30,764)	(20,789)
Other noncurrent items, net	(1,096)	(762)
<i>Cash Provided by Operating Activities</i>	28,521	23,583
<b>Investing Activities:</b>		
Capital expenditures	(29,164)	(15,467)
Capital contributions to investments	(178)	(355)
Other	(184)	49
<i>Cash Used for Investing Activities</i>	(29,526)	(15,773)
<b>Financing Activities:</b>		
Cash dividends paid to parent by MGE	-	(6,728)
Distributions to parent from noncontrolling interest	(5,500)	-
Equity contribution received by noncontrolling interest	178	355
Repayment of long-term debt	(667)	(667)
Increase in short-term debt	10,500	-
Other	-	(9)
<i>Cash Provided by (Used for) Financing Activities</i>	4,511	(7,049)
Change in cash and cash equivalents	3,506	761
Cash and cash equivalents at beginning of period	6,350	13,898
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 9,856</b>	<b>\$ 14,659</b>

**Supplemental disclosures of cash flow information:**

Significant noncash investing activities:

Accrued capital expenditures	\$	12,699	\$	4,674
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*The accompanying notes are an integral part of the unaudited consolidated financial statements.*

**Madison Gas and Electric Company****Consolidated Balance Sheets (unaudited)***(In thousands)*

	<b>March 31, 2013</b>	<b>December 31, 2012</b>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 9,856	\$ 6,350
Receivable - margin account	766	1,818
Accounts receivable, less reserves of \$3,914 and \$3,885, respectively	46,864	41,386
Affiliate receivables	619	634
Other accounts receivable, less reserves of \$931 and \$931, respectively	5,124	6,732
Unbilled revenues	26,761	28,262
Materials and supplies, at average cost	16,933	16,997
Fossil fuel	7,375	6,367
Stored natural gas, at average cost	2,195	14,980
Prepaid taxes	18,108	23,561
Regulatory assets - current	8,471	10,327
Deferred income taxes - current	13,808	23,305
Other current assets	7,416	6,670
<i>Total Current Assets</i>	164,296	187,389
Affiliate receivable long-term	6,222	6,354
Regulatory assets	214,496	218,853
Other deferred assets and other	6,602	6,540
<b>Property, Plant, and Equipment:</b>		
Property, plant, and equipment, net	980,820	974,549
Construction work in progress	115,803	98,411
<i>Total Property, Plant, and Equipment</i>	1,096,623	1,072,960
<b>Investments</b>	62,366	61,555
<b>Total Assets</b>	\$ 1,550,605	\$ 1,553,651
<b>LIABILITIES AND CAPITALIZATION</b>		
<b>Current Liabilities:</b>		
Long-term debt due within one year	\$ 3,365	\$ 3,013
Short-term debt	10,500	-
Accounts payable	39,586	43,517
Affiliate payables	405	767
Accrued interest and taxes	3,699	4,248
Accrued payroll related items	7,711	10,063
Derivative liabilities	8,880	9,270
Other current liabilities	10,163	4,491
<i>Total Current Liabilities</i>	84,309	75,369
<b>Other Credits:</b>		
Deferred income taxes	268,028	266,231
Investment tax credit - deferred	1,466	1,520
Regulatory liabilities	22,598	24,538
Accrued pension and other postretirement benefits	133,380	162,835

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Derivative liabilities	61,810	63,320
Other deferred liabilities and other	53,505	50,581
<i>Total Other Credits</i>	540,787	569,025
<b>Capitalization:</b>		
Common shareholder's equity	449,057	433,296
Noncontrolling interest	118,974	117,470
<i>Total Equity</i>	568,031	550,766
Long-term debt	357,478	358,491
<i>Total Capitalization</i>	925,509	909,257
Commitments and contingencies (see Footnote 8)	-	-
<b>Total Liabilities and Capitalization</b>	<b>\$ 1,550,605</b>	<b>\$ 1,553,651</b>

*The accompanying notes are an integral part of the above unaudited consolidated financial statements.*



**Madison Gas and Electric Company****Consolidated Statements of Common Equity (unaudited)***(In thousands)*

	Common Stock Shares	Common Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Non- Controlling Interest	Total
<b>2012</b>							
Beginning balance - Dec. 31, 2011	17,348	\$ 17,348	\$ 192,417	\$ 203,114	\$ 47	\$ 114,351	\$ 527,277
Net income				10,142		6,072	16,214
Other comprehensive loss					(16)		(16)
Cash dividends paid to parent by MGE				(6,728)			(6,728)
Equity contribution received by noncontrolling interest						355	355
Ending balance - March 31, 2012	17,348	\$ 17,348	\$ 192,417	\$ 206,528	\$ 31	\$ 120,778	\$ 537,102
<b>2013</b>							
Beginning balance - Dec. 31, 2012	17,348	\$ 17,348	\$ 192,417	\$ 223,527	\$ 4	\$ 117,470	\$ 550,766
Net income				15,734		6,826	22,560
Other comprehensive loss					27		27
Equity contribution received by noncontrolling interest						178	178
Distributions to parent from noncontrolling interest						(5,500)	(5,500)
Ending balance - March 31, 2013	17,348	\$ 17,348	\$ 192,417	\$ 239,261	\$ 31	\$ 118,974	\$ 568,031

*The accompanying notes are an integral part of the above unaudited consolidated financial statements.*



**MGE Energy, Inc., and Madison Gas and Electric Company**

**Notes to Consolidated Financial Statements (unaudited)**

**March 31, 2013**

**1.**

**Basis of Presentation - MGE Energy and MGE.**

This report is a combined report of MGE Energy and MGE. References in this report to "MGE Energy" are to MGE Energy, Inc., and its subsidiaries. References in this report to "MGE" are to Madison Gas and Electric Company.

MGE Power Elm Road and MGE Power West Campus own electric generating assets and lease those assets to MGE. Both entities are variable interest entities under applicable authoritative guidance. MGE is considered the primary beneficiary of these entities as a result of contractual agreements. As a result, MGE has consolidated MGE Power Elm Road and MGE Power West Campus. See Footnote 2 of Notes to Consolidated Financial Statements under Item 8, Financial Statements and Supplementary Data, of MGE Energy's and MGE's 2012 Annual Report on Form 10-K.

The accompanying consolidated financial statements as of March 31, 2013, and for the three months ended, are unaudited, but include all adjustments that MGE Energy and MGE management consider necessary for a fair statement of their respective financial statements. All adjustments are of a normal, recurring nature except as otherwise disclosed. The year-end consolidated balance sheet information was derived from the audited balance sheet appearing in MGE Energy's and MGE's 2012 Annual Report on Form 10-K, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These notes should be read in conjunction with the financial statements and the notes on pages 51 through 104 of the 2012 Annual Report on Form 10-K.

**2.**

**Equity and Financing Arrangements - MGE Energy.**

**a.**

**Common Stock.**

MGE Energy purchases stock in the open market for issuance pursuant to its Stock Plan. All MGE Energy common stock issued under the Stock Plan is sold pursuant to a registration statement that has been filed with the SEC and is currently effective.

MGE Energy can issue new shares of its common stock through the Stock Plan. For both the three months ended March 31, 2013 and 2012, MGE Energy did not issue any new shares of common stock under the Stock Plan.

**b.**

**Dilutive Shares Calculation.**

MGE Energy does not hold any dilutive securities.

**3.**

**Investment in ATC - MGE Energy and MGE.**

ATC owns and operates electric transmission facilities primarily in Wisconsin. MGE received an interest in ATC when it, like other Wisconsin electric utilities, contributed its electric transmission facilities to ATC. That interest is presently held by MGE Transco, which is jointly owned by MGE Energy and MGE.

MGE Transco has accounted for its investment in ATC under the equity method of accounting. For the three months ended March 31, 2013 and 2012, MGE Transco recorded equity earnings from the investment in ATC of \$2.4 million and \$2.2 million, respectively. Dividend income received from ATC was \$1.8 million and \$1.7 million for the three months ended March 31, 2013 and 2012, respectively. In addition, during the three months ended March 31, 2013 and 2012, MGE Transco made \$0.2 million and \$0.4 million in capital contributions to ATC, respectively. On April 30, 2013, MGE Transco made a \$0.5 million capital contribution to ATC.

MGE Energy and MGE's investment in ATC as of March 31, 2013, and December 31, 2012, was \$61.8 million and \$61.0 million, respectively.



At March 31, 2013, MGE is the majority owner, and MGE Energy, the holding company, is the minority owner of MGE Transco. MGE Energy's proportionate share of the equity and net income of MGE Transco is classified within the MGE financial statements as noncontrolling interest.

ATC's summarized financial data for the three months ended March 31, 2013 and 2012, is as follows:

	Three Months Ended	
	March 31,	
<i>(In thousands)</i>	2013	2012
Operating revenues	\$ 151,737	\$ 147,662
Operating expenses	(69,770)	(69,566)
Other expense, net	(448)	(500)
Interest expense, net	(21,044)	(19,501)
Earnings before members' income taxes	\$ 60,475	\$ 58,095

#### 4.

#### **Columbia Environmental Project Construction - MGE Energy and MGE.**

MGE and two other utilities jointly own Columbia, a coal-fired generating facility. WPL is the plant operator and permit holder, and owns 46.2% of Columbia. WPSC owns a 31.8% interest, and MGE owns a 22% interest, in Columbia. In early 2011, the PSCW issued a *Certificate and Order* authorizing the construction of scrubbers and bag houses and associated equipment on Columbia Units 1 and 2 to reduce SO<sub>2</sub> and mercury emissions. The scrubbers and bag houses are expected to support compliance obligations for current and anticipated air quality regulations, including CAIR, CAIR's eventual replacement, the Mercury and Air Toxics Standards (MATS), and the Wisconsin Mercury Rule. The operator's current estimate shows that MGE's share of the capital expenditures required for this project is approximately \$140 million. As of March 31, 2013, MGE had accumulated \$78.8 million (excluding carrying costs) related to its share of the project, which is reflected in the Construction Work in Progress balance on MGE Energy's and MGE's consolidated balance sheets. MGE's share of the capital expenditures associated with the Columbia environmental project will be approximately \$49 million for the remainder of 2013 and \$12 million in 2014. These amounts may change as a result of modifications to the project estimate or timing differences. For the three months ended March 31, 2013 and 2012, MGE has recognized after tax \$0.5 million and \$0.1 million, respectively, in AFUDC equity related to this project.

MGE expects that the costs pertaining to this project will be fully recoverable through rates. In 2012, the PSCW authorized MGE 100% AFUDC on this project during construction. Beginning in 2013, similar to MGE's other utility construction projects, the PSCW authorized MGE a 50% current return (included in customer rates) and the remaining 50% as AFUDC.

5.

**Taxes - MGE Energy and MGE.**

a.

**Accounting for Uncertainty in Income Taxes.**

MGE Energy and MGE account for the difference between the tax benefit amount taken on prior year tax returns, or expected to be taken on a current year tax return, and the tax benefit amount recognized in the financial statements as an unrecognized tax benefit.

MGE Energy has adopted a tax method of accounting to accelerate tax deductions for repairs. MGE Energy and MGE have an unrecognized tax benefit at March 31, 2013, and December 31, 2012, in the amount of \$3.4 million and \$3.2 million, respectively, for the tax uncertainty related to the change in tax method of accounting for repairs.

On April 18, 2013, MGE Energy received notification from the Internal Revenue Service that the examination of tax periods 2007-2009 has been completed. Unrecognized tax benefits of \$1.5 million related to those years will be reversed (in the second quarter) due to those positions not being adversely adjusted in the examination.

b.

**Effective Tax Rate.**

MGE Energy's and MGE's effective income tax rate for the three months ended March 31, 2013, was 37.7%, compared to 38.1% for the same period in 2012.

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6.

**Pension and Other Postretirement Plans - MGE Energy and MGE.**

MGE maintains qualified and nonqualified pension plans, health care, and life insurance benefits. Additionally, MGE has defined contribution 401(k) benefit plans.

The following table presents the components of MGE Energy's and MGE's net periodic benefit costs recognized for the three months ended March 31, 2013 and 2012. A portion of the net periodic benefit cost is capitalized within the consolidated balance sheets.

<i>(In thousands)</i>	Three Months Ended	
	2013	March 31, 2012
<b>Pension Benefits</b>		
Components of net periodic benefit cost:		
Service cost	\$ 1,929	\$ 1,823
Interest cost	3,186	3,154
Expected return on assets	(4,776)	(3,818)
Amortization of:		
Prior service cost	79	108
Actuarial loss	2,015	2,006
Net periodic benefit cost	\$ 2,433	\$ 3,273
<b>Postretirement Benefits</b>		
Components of net periodic benefit cost:		
Service cost	\$ 596	\$ 647
Interest cost	970	1,125
Expected return on assets	(544)	(435)
Amortization of:		
Transition obligation	1	106
Prior service cost	28	28
Actuarial loss	311	621
Net periodic benefit cost	\$ 1,362	\$ 2,092

The PSCW allowed MGE to defer the 2009 incremental pension and OPRB costs above the amounts recovered in rates. During both the three months ended March 31, 2013 and 2012, \$0.3 million has been recovered in rates. These costs are not reflected in the table above.

7.



**Share-Based Compensation - MGE Energy and MGE.**

Under MGE Energy's Performance Unit Plan, eligible participants may receive performance units that entitle the holder to receive a cash payment equal to the value of a designated number of shares of MGE Energy's common stock, plus dividend equivalent payments thereon, at the end of the set performance period.

In addition to units granted in 2009 through 2012, on February 15, 2013, 15,256 units were granted based on the MGE Energy closing stock price as of that date. These units are subject to a five-year graded vesting schedule. On the grant date, MGE Energy and MGE measure the cost of the employee services received in exchange for a performance unit award based on the current market value of MGE Energy common stock. The fair value of the awards has been subsequently re-measured at March 31, 2013, as required by applicable accounting standards. Changes in fair value have been recognized as compensation cost. Since this amount is re-measured quarterly throughout the vesting period, the compensation cost is subject to variability.

For nonretirement eligible employees, stock based compensation costs are accrued and recognized using the graded vesting method. Compensation cost for retirement eligible employees or employees that will become retirement eligible during the vesting schedule are recognized on an abridged horizon. In the event of a bona fide retirement, not followed by work for a competitor, the executive will receive full vesting credit for each outstanding award.

During the three months ended March 31, 2013 and 2012, MGE recorded \$0.9 million and \$0.4 million, respectively, in compensation expense as a result of the Performance Unit Plan. In January 2013, cash payments of \$1.0 million were distributed relating to awards that were granted in 2008 and became payable under the Performance Unit Plan. No forfeitures occurred during the three months ended March 31, 2013 or 2012. At March 31, 2013, \$3.7 million of outstanding awards are vested.

8.

**Commitments and Contingencies.**

a.

**Environmental - MGE Energy and MGE.**

**Water Quality**

Water quality regulations promulgated by the EPA and WDNR in accordance with the Federal Water Pollution Control Act, or more commonly known as the Clean Water Act (CWA), impose restrictions on discharges of various pollutants into surface waters. The CWA also regulates surface water quality issues that affect aquatic life, such as water temperatures, intake structures, and wetlands filling. The CWA also includes discharge standards, which require the use of effluent-treatment processes equivalent to categorical "best practicable" or "best available" technologies. The CWA regulates discharges from "point sources" such as power plants through establishing discharge limits in water discharge permits. MGE's power plants operate under Wisconsin Pollution Discharge Elimination System (WPDES) permits to ensure compliance with these discharge limits.

*EPA Cooling Water Intake Rules (Section 316(b))*

Section 316(b) of the Clean Water Act requires that the cooling water intake structures at electric power plants meet best available technology standards so that mortality from entrainment (drawing aquatic life into a plant's cooling system) and impingement (trapping aquatic life on screens) are reduced. Section 316(b) has been introduced in two phases. Phase I, which has been finalized, covered new facilities at the time that the rule was introduced. Phase II, which has not been finalized, is designed to cover what is defined as existing facilities. The EPA issued a proposed Phase II rule and alternative compliance strategies for existing facilities in April 2011 and has until June 27, 2013, to issue a final rule, pursuant to a settlement agreement.

The currently proposed Phase II rule and potential alternatives allow for a state permitting agency's discretion in determining best technology available at plants that are under their permitting authority and is not requiring cooling towers in all instances. The WDNR holds permitting authority for Wisconsin and implementation of the rule will be through modification of the plants' WPDES permits. Blount and Columbia generating plants are subject to both the

impingement and entrainment aspects of the current proposed rule. WCCF is subject to the impingement aspect only. The Elm Road Units are covered under Phase I of the rule and meets those requirements. We anticipate that under the current proposed rule, equipment would need to be installed at Blount, WCCF, and Columbia to meet these new standards. However it is not presently possible to estimate the potential costs associated with this rule because the rule has not been finalized.

## **Air Quality**

Federal and state air quality regulations impose restrictions on emission of particulate matter (PM), sulfur dioxide (SO<sub>2</sub>), nitrogen oxides (NO<sub>x</sub>), and other pollutants and require permits for operation of emission sources. These permits have been obtained by MGE and must be renewed periodically. Various initiatives, including interstate pollution transport rules, maximum achievable control technology (MACT) standards, new source performance standards (NSPS), the Clean Air Visibility Rule (also known as the Regional Haze Rule), and mercury emissions limits are expected to result in additional operating and capital expenditure costs for electric generating units.

### *Vacation of EPA's Cross State Air Pollution Rule (CSAPR) and Reinstatement of the Clean Air Interstate Rule (CAIR)*

In 2005, EPA promulgated the Clean Air Interstate Rule (CAIR) to reduce ozone and fine particulate matter emissions by reducing NO<sub>x</sub> and SO<sub>2</sub> emissions. NO<sub>x</sub> and SO<sub>2</sub> interact in the atmosphere to form ambient ozone from NO<sub>x</sub> and fine particulate matter pollution from NO<sub>x</sub> and SO<sub>2</sub>. The CAIR generally requires NO<sub>x</sub> and SO<sub>2</sub> emission reductions from fossil fuel-fired EGUs (25 MW or greater) in the eastern half of the United States in two phases and includes a regional cap-and-trade system. The first phase (currently in place)

requires annual regional emission reductions from 2003 levels of 55% for NO<sub>x</sub> and 40% for SO<sub>2</sub>. The second phase (beginning in 2015) reduces regional NO<sub>x</sub> and SO<sub>2</sub> emissions further from 2003 levels to 65% and 70%, respectively. MGE owns or has partial ownership in several generation units currently subject to the CAIR: Blount, Columbia, Elm Road Units, and its combustion turbines located in West Marinette and Fitchburg.

In December 2008, the U.S. Court of Appeals for the D.C. Circuit remanded the CAIR to the EPA with directions to revise or replace the rule. The Court's remand order directed that the CAIR remain in effect until the EPA promulgated a replacement rule. The Court's order did not include a deadline for the EPA to act.

In August 2011, the EPA responded to the remand of the CAIR by promulgating the Cross State Air Pollution Rule (CSAPR). However, in August 2012, the U.S. Court of Appeals for the D.C. Circuit vacated CSAPR and instructed the EPA to continue administering the CAIR pending finalizing a valid alternative program to control interstate pollution. In January 2013, the U.S. Court of Appeals for the D.C. Circuit denied the EPA's petition for reconsideration *en banc*. The EPA and several environmental groups have appealed the D.C. Circuit Court's August 2012 decision to the Supreme Court in separate filings. At this time, the CAIR remains effective.

MGE is currently in compliance with the CAIR Phase I requirements. MGE will be able to meet Phase II NO<sub>x</sub> emissions reductions through using our NO<sub>x</sub> allowances provided through the rule, and we will meet Phase II SO<sub>2</sub> emissions reductions through installation of pollution controls. New SO<sub>2</sub> controls at Columbia are already underway and are planned to be completed by mid 2014 (see the discussion regarding the Columbia environmental project below). MGE expects that any costs incurred to meet Phase II of the CAIR will be fully recoverable through rates. MGE will monitor the Supreme Court's response to the CSAPR appeals and any subsequent actions by the EPA to continue to evaluate potential impacts to our operations.

#### Clean Air Visibility Rule (CAVR)

Air modeling indicates that SO<sub>2</sub> and NO<sub>x</sub> emissions (and to a lesser extent particulate matter) from Columbia may impair visibility at certain Class I Scenic Areas and may therefore be subject to the best available retrofit technology (BART) regulations, a subsection of the EPA's Clean Air Visibility Rule (CAVR), which may require pollution retrofits. The EPA had proposed that a power plant's compliance with emissions limitations in the CAIR and later under CSAPR could also serve as compliance with the BART regulations for SO<sub>2</sub> and NO<sub>x</sub> emissions. However, this proposal is now uncertain because of the D.C. Circuit decisions to remand the CAIR and vacate CSAPR and the EPA's decision to pursue Supreme Court review of the CSAPR vacature. See CAIR and CSAPR discussion above for additional information on these proceedings. Capital expenditures at Columbia under BART still remain a possibility however at this time, the BART regulatory obligations, compliance strategies and costs remain uncertain until the Supreme Court makes a decision regarding CSAPR.

#### Wisconsin State Mercury Rule

Beginning January 1, 2015, phase two of the Wisconsin mercury rule will require large coal-fired EGUs (larger than 150 MW) to reduce mercury emissions by 90%, or choose a multi-pollutant reduction approach, which allows a

stepped approach to mercury reduction while reducing NO<sub>x</sub> and SO<sub>2</sub> emissions at prescribed rates. The Elm Road Units currently meet this requirement. The Columbia co-owners expect to meet the 90% reduction option by installing baghouses and scrubbers by mid 2014 (see the discussion regarding the Columbia environmental project below). With the finalization of the EPA's Mercury and Air Toxics Standard, or MATs, the WDNR is currently evaluating how the state mercury rule should be supplanted by the EPA's rule (see discussion on MATs below).

*Mercury and Air Toxics Standards (MATs) for Utility Boilers (Also Referred to as the Maximum Achievable Control Technology, or MACT)*

In December 2011, the EPA finalized its Mercury and Air Toxics Standards for coal and oil-burning EGU boilers. MATs will require emissions standards for mercury, non-mercury HAPs metals, and acid gases. Compliance with MATs is generally required three years from the rule issuance, but permitting authorities can grant an additional year for compliance to facilities. MGE's Columbia and Elm Road Units are subject to MATs. The Elm Road Unit's current pollution controls, and Columbia's planned mercury pollution controls (baghouse and scrubbers) to be installed by mid 2014, are expected to allow both facilities to comply with the MATs rule without extensions (see the discussion regarding Columbia environmental project below).

National Ambient Air Quality Standards

The EPA has developed National Ambient Air Quality Standards (NAAQS) for six compounds currently identified as criteria pollutants: nitrogen dioxide, particulate matter, ozone, sulfur dioxide, lead, and carbon monoxide. The NAAQS for criteria pollutants establish acceptable ambient air levels of each pollutant based on a review of their effects to human health and the environment, and changes to those NAAQS can affect compliance requirements and associated capital and operating costs. The EPA is required to review NAAQS every five years.

Certain stationary sources, such as MGE's generation facilities, must meet NAAQS standards for emissions that travel offsite. Stationary source air quality modeling is used to determine whether emissions from permitted sources meet these NAAQS. Failure to meet NAAQS may require a permit applicant to incur capital or operational costs to bring a source into compliance. We cannot predict if MGE's permitted stationary sources will have difficulty meeting new standards not previously modeled. Modeling performed by the WDNR for MGE's permitted facilities has demonstrated compliance with current NAAQS. Additional modeling may be required in future permitting actions.

MGE tracks NAAQS developments to determine if new standards may affect us. MGE is currently tracking two NAAQS developments: (1) determination and placement of monitoring networks in Wisconsin for the 2010 nitrogen dioxide (NO<sub>2</sub>) NAAQS (Wisconsin is currently considered in attainment with NO<sub>2</sub> NAAQS, however stationary source modeling may be required for NO<sub>2</sub> in the future) and (2) implementation requirements under the 2010 sulfur dioxide (SO<sub>2</sub>) NAAQS. The EPA has issued draft guidance that indicates larger sources, such as Columbia, may be required to install ambient air monitors and/or perform dispersion modeling to demonstrate attainment. A concern has been raised regarding the current EPA-preferred dispersion model. The model may not be accurate for estimating SO<sub>2</sub> stationary source impacts and may overestimate off-site concentrations of SO<sub>2</sub> from stationary sources. The EPA is working to resolve issues with the model.

Reciprocating Internal Combustion Engine (RICE) MACT Standard

In January 2013, the EPA finalized amendments to its RICE MACT standard. RICE MACT applies to industrial or electrical engines that are classified as reciprocating internal combustion engines. Engines owned by MGE that would fall under the RICE MACT rule include backup generators and small engines at various locations, including our fleet of distributed generators that serve as electric system backup and emergency dispatch. The distributed generators in particular will either require additional pollution controls or a change in how they are dispatched. MGE is continuing to evaluate the impacts to our engines based on this new standard, including evaluating the costs associated with adding pollution controls on some or all our aforementioned distributed generators.

Greenhouse Gas Regulation

On March 27, 2012, the EPA proposed GHG New Source Performance Standards (NSPS) for coal fired and natural gas combined cycle (NGCC) EGUs. The proposal applies to new EGUs only.

However, the EPA plans to propose NSPS for existing units some time in 2013 as part of a 2010 settlement agreement. There is a great deal of uncertainty as to what the EPA will include in their NSPS for existing units and thus we are unable to comment on potential impacts to MGE at this time.

## **Columbia**

MGE and two other utilities jointly own Columbia, a coal-fired generating facility, which accounts for 225 MW (29%) of MGE's net summer generating capability. WPL is the plant operator and permit holder, and owns 46.2% of Columbia. Wisconsin Public Service Corporation (WPSC) owns a 31.8% interest, and MGE owns a 22% interest in Columbia. Based upon current available information, compliance with various environmental requirements and initiatives is expected to result in significant additional operating and capital expenditures at Columbia.

### *Columbia Environmental Project*

In early 2011, the PSCW issued a *Certificate and Order* authorizing the construction of scrubbers and bag houses and associated equipment on Columbia Units 1 and 2 to reduce SO<sub>2</sub> and mercury emissions. The scrubbers and bag houses are expected to support compliance obligations for current and anticipated air quality regulations, including CAIR, CAIR's eventual replacement, the Mercury and Air Toxics Standards

(MATs), and the Wisconsin Mercury Rule. WPL, the plant operator, currently estimates that MGE's share of the capital expenditures required for this project is approximately \$140 million. The project is underway and estimated to be completed by mid 2014.

MGE's share of various contractual commitments entered for the project as of March 31, 2013, is \$56.7 million. These costs are expected to be capitalized and included in the consolidated balance sheets of MGE Energy and MGE. See Footnote 4 for further information regarding the Columbia environmental construction project.

#### *Title V Operating Permit Petition*

In September 2008, the WDNR issued a Title V renewal operating permit to WPL for Columbia. However, a citizen group petitioned the EPA to object to the permit renewal. In October 2009, the EPA issued an order granting in part and denying in part the petition and sent the operating permit back to the WDNR for further review based on the EPA order. In February 2011, the citizen group involved filed an action against the EPA in the U.S. District Court for the Western District of Wisconsin seeking to have the EPA take over the permit process. In June 2012, the EPA notified the plant operator of its intent to assume responsibility for issuing the renewed operating permit for Columbia, but agreed to provide the plant operator with more time to potentially resolve the issues raised in the EPA's order. On February 4, 2013, the parties involved dismissed the litigation without prejudice. The matter is still pending at the EPA but has been postponed pending possible resolution of the Clean Air Act litigation discussed below. MGE believes the permits currently in effect for Columbia remain in place at this time. MGE continues to follow these developments and is unable to predict the outcome of this matter and its impact on its operations or financial condition.

#### *Columbia Clean Air Act Litigation*

In December 2009, the EPA sent a notice of violation (NOV) to MGE as one of the co-owners of Columbia. The NOV alleges that WPL, as operator, and the co-owners (WPL, WPS, and MGE) failed to comply with appropriate pre-construction review and permitting requirements and, as a result, violated the PSD program requirements, the Title V operating permit requirements of the CAA and the Wisconsin State Implementation Plan (SIP). In September 2010, Sierra Club filed a lawsuit against WPL alleging violations of the CAA at Columbia and other WPL-operated Wisconsin facilities. WPL responded that the projects at Columbia were routine, or not projected to increase emissions, and therefore did not violate the permitting requirements of the CAA.

In April 2013, WPL, as operator, along with the other owners of Columbia (MGE and WPS), entered into a consent decree with the EPA and the Sierra Club to resolve these claims, while admitting no liability. The consent decree has been lodged with, and is subject to approval by, the Court, which could occur in the second quarter of 2013. The consent decree, requires installation of the following emission controls at Columbia; scrubbers and baghouses at Columbia Units 1 and 2 by December 31, 2014 and an SCR system at Columbia Unit 2 by December 31, 2018. In addition, the consent decree establishes emission rate limits for SO<sub>2</sub>, nitrogen oxide (NO<sub>x</sub>) and particulate matter for Columbia Units 1 and 2. The consent decree also includes annual plant-wide emission caps for SO<sub>2</sub> and NO<sub>x</sub> for Columbia. MGE will also pay approximately \$0.2 million as its share of a civil penalty and complete approximately \$0.6 million in environmental mitigation projects. MGE currently expects to recover any material costs that could be incurred by MGE related to the terms of the final consent decree from MGE's electric customers, except for costs



related to the civil penalty. In accordance with applicable accounting standards, MGE has accrued an amount for this matter representing its best estimate of its probable liability, based upon its assessment of the settlement. That accrued amount is not material to the financial statements. MGE believes the likelihood of a materially greater liability than the accrued amount is remote based upon the current status.

**b.**

**Chattel Paper Agreement and Other Guarantees - MGE Energy and MGE.**

MGE makes available to qualifying customers a financing program for the purchase and installation of energy-related equipment that will provide more efficient use of utility service at the customer's property. MGE is party to a chattel paper purchase agreement with a financial institution under which it can sell or finance an undivided interest with recourse, in up to \$10.0 million of the financing program receivables, until July 31, 2013. At March 31, 2013, MGE has outstanding a \$4.3 million interest in these receivables. MGE retains the servicing responsibility for these receivables. As of March 31, 2013, the servicing asset recognized by MGE is \$0.2 million.

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MGE accounts for servicing rights under the amortization method. Initial determination of the servicing asset fair value is based on the present value of the estimated future cash flows. The discount rate is based on the PSCW authorized weighted cost of capital.

MGE would be required to perform under its guarantee if a customer defaulted on its loan. The energy-related equipment installed at the customer sites is used to secure the customer loans. The loan balances outstanding at March 31, 2013, approximate the fair value of the energy-related equipment acting as collateral. The length of the MGE guarantee to the financial institution varies from one to ten years depending on the term of the underlying customer loan. Principal payments for the remainder of 2013 and the next four years on the loans are:

<i>(In thousands)</i>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Chattel Paper	\$ 531	\$ 554	\$ 867	\$ 791	\$ 382

**c.**

#### **Legal Matters - MGE Energy and MGE.**

MGE is involved in various legal matters that are being defended and handled in the normal course of business, including the Columbia matters discussed above. MGE maintains accruals for such costs that are probable of being incurred and subject to reasonable estimation. The accrued amount for these matters is not material to the financial statements.

**d.**

#### **Purchase Contracts - MGE Energy and MGE.**

MGE Energy and MGE have entered into various commodity supply, transportation and storage contracts to meet their obligations to deliver electricity and natural gas to customers. As of March 31, 2013, the future commitments related to these purchase contracts were as follows:

<i>(In thousands)</i>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Coal <sup>(a)</sup>	\$ 16,922	\$ 9,933	\$ 9,252	\$ 1,623	\$ 1,040
Purchase power <sup>(b)</sup>	49,182	48,425	47,293	48,121	49,242
Other	1,939	-	-	-	-
	\$ 68,043	\$ 58,358	\$ 56,545	\$ 49,744	\$ 50,282

*(a)*

*Total coal commitments for the Columbia and Elm Road Units, including transportation. Fuel procurement for MGE's jointly owned Columbia and Elm Road Units are handled by WPL and WEPCO, respectively, who are the operators of those facilities. If any minimum purchase obligations must be paid under these contracts, management believes these obligations would be considered costs of service and recoverable in rates.*

(b)

*MGE has several purchase power agreements to help meet future electric supply requirements. Management expects to recover these costs in future customer rates.*

e.

**Smart Grid Investment Grant - MGE Energy and MGE.**

MGE was approved in 2010 by the U.S. Department of Energy (DOE) under the federal stimulus program for a \$5.5 million grant for smart grid projects. The DOE grant requires MGE to match the grant funding, bringing the total cost of the projects to more than \$11 million. The projects involve the installation of technologies to boost efficiency, enhance service, and improve reliability for customers. The stimulus grant is being used to fund the following projects: advanced metering infrastructure, plug-in hybrid electric vehicles support, and distribution management. As of March 31, 2013, MGE has spent \$9.6 million related to these projects and has outstanding agreements to purchase \$0.9 million in smart grid related products for the remainder of 2013.

9.

**Derivative and Hedging Instruments - MGE Energy and MGE.**

a.

**Purpose.**

As part of its regular operations, MGE enters into contracts, including options, swaps, futures, forwards, and other contractual commitments, to manage its exposure to commodity prices and gas revenues. To the extent that these contracts are derivatives, MGE assesses whether or not the normal purchases or normal sales exclusion applies. For contracts to which this exclusion cannot be applied, MGE Energy and MGE recognize such derivatives in the consolidated balance sheets at fair value. The majority of MGE's derivative activities are conducted in accordance with its electric and gas risk management program, which is approved by the PSCW and limits the volume MGE can hedge with specific risk management strategies. The maximum length of time over which cash flows related to energy commodities can be hedged is four years. If the derivative qualifies for regulatory deferral, the derivatives are marked to fair value and are offset with a corresponding regulatory asset or liability. The deferred gain or loss is recognized in earnings in the delivery month applicable to the instrument. Gains and losses related to hedges qualifying for regulatory treatment are recoverable in gas rates through the PGA or in electric rates as a component of the fuel rules mechanism.

b.

**Notional Amounts.**

The gross notional volume of open derivatives is as follows:

	March 31, 2013	December 31, 2012
Commodity derivative contracts	331,315 MWh	444,650 MWh
Commodity derivative contracts	1,360,000 Dth	1,980,000 Dth
FTRs	1,085 MW	2,670 MW

c.

**Financial Statement Presentation.**

MGE Energy and MGE offset fair value amounts recognized for the right to reclaim collateral (a receivable) or the obligation to return collateral (a payable) against fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting agreement.

MGE purchases and sells exchange-traded and over-the-counter options, swaps, and future contracts. These arrangements are primarily entered into to help stabilize the price risk associated with gas or power purchases. These transactions are employed by both MGE's gas and electric segments. Additionally, as a result of the firm transmission agreements that MGE holds on transmission paths in the MISO market, MGE holds FTRs. An FTR is a financial instrument that entitles the holder to a stream of revenues or charges based on the differences in hourly day-ahead energy prices between two points on the transmission grid. The fair values of these instruments are reflected as a regulatory asset/liability depending on whether they are in a net loss/gain position. Depending on the nature of the instrument, the gain or loss associated with these transactions will be reflected as cost of gas sold, fuel for electric generation, or purchased power expense in the delivery month applicable to the instrument. At March 31, 2013, and December 31, 2012, the fair value of exchange traded derivatives and FTRs exceeded their cost basis by \$1.5 million and \$0.3 million, respectively.

MGE is a party to a ten-year purchased power agreement that provides MGE with firm capacity and energy during a base term from June 1, 2012, through May 31, 2022. The agreement also allows MGE an option to extend the contract after the base term. The agreement is accounted for as a derivative contract and is recognized at its fair value on the consolidated balance sheet. However, the derivative qualifies for regulatory deferral and is recognized with a corresponding regulatory asset or liability depending on whether the fair value is in a loss or gain position. The fair value of the contract at March 31, 2013, and December 31, 2012, reflects a loss position of \$70.7 million and \$72.6 million, respectively. The actual fuel cost will be recognized in purchased power expense in the month of purchase.

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The following table summarizes the fair value of the derivative instruments on the consolidated balance sheet. All derivative instruments in this table are presented on a gross basis and are calculated prior to the netting of instruments with the same counterparty under a master netting agreement as well as the netting of collateral. For financial statement purposes, MGE Energy and MGE have netted instruments with the same counterparty under a master netting agreement as well as the netting of collateral.

<i>(In thousands)</i>	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>March 31, 2013</b>				
Commodity derivative contracts	Other current assets	\$ 1,343	Derivative liability (current)	\$ 30
Commodity derivative contracts	Other deferred charges	158	Derivative liability (long-term)	-
FTRs	Other current assets	22	Derivative liability (current)	-
Ten-year PPA	N/A	N/A	Derivative liability (current)	8,880
Ten-year PPA	N/A	N/A	Derivative liability (long-term)	61,810
<b>December 31, 2012</b>				
Commodity derivative contracts	Other current assets	\$ 365	Derivative liability (current)	\$ 394
Commodity derivative contracts	Other deferred charges	95	Derivative liability (long-term)	11
FTRs	Other current assets	206	Derivative liability (current)	-
Ten-year PPA	N/A	N/A	Derivative liability (current)	9,270
Ten-year PPA	N/A	N/A	Derivative liability (long-term)	63,320

The following tables show the effect of netting arrangements for recognized derivative assets and liabilities that are subject to a master netting arrangement or similar arrangement on the balance sheet.

**Offsetting of Derivative Assets**

<i>(In thousands)</i>	Gross amounts	Gross amounts	Collateral	Net amount
		offset in	posted against	presented in
	Gross amounts	balance sheet	derivative positions	balance sheet
<b>March 31, 2013</b>				

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Commodity derivative contracts	\$	1,502	\$	(30)	\$	(465)	\$	1,007
FTRs		22		-		-		22

**December 31, 2012**

Commodity derivative contracts	\$	460	\$	(405)	\$	-	\$	55
FTRs		206		-		-		206

**Offsetting of Derivative Liabilities**

		Gross amounts		Collateral		Net amount
			offset in	posted against		presented in
	Gross amounts		balance sheet	derivative positions		balance sheet
<i>(In thousands)</i>						
<b>March 31, 2013</b>						
Commodity derivative contracts	\$	30	\$	(30)	\$	-
Ten-year PPA		70,690		-		70,690
<b>December 31, 2012</b>						
Commodity derivative contracts	\$	405	\$	(405)	\$	-
Ten-year PPA		72,590		-		72,590

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The following tables summarize the unrealized and realized gains (losses) related to the derivative instruments on the consolidated balance sheet at March 31, 2013 and 2012, and the consolidated income statement for the three months ended March 31, 2013 and 2012.

	2013		2012	
	Current and long-term regulatory asset	Other current assets	Current and long-term regulatory asset	Other current assets
<i>(In thousands)</i>				
<b>Three Months Ended March 31:</b>				
Balance at January 1,	\$ 72,329	\$ 574	\$ 42,356	\$ 1,604
Change in unrealized (gain) loss	(1,697)	-	33,310	-
Realized loss reclassified to a deferred account	(290)	290	(2,658)	2,658
Realized loss reclassified to income statement	(1,145)	(605)	(1,494)	(3,590)
Balance at March 31,	\$ 69,197	\$ 259	\$ 71,514	\$ 672

	Realized losses (gains) Fuel for electric		
	Regulated gas revenues	generation/ purchased power	Cost of gas sold
<i>(In thousands)</i>			
<b>Three Months Ended March 31, 2013:</b>			
Commodity derivative contracts	\$ -	\$ 22	\$ 608
FTRs	-	(158)	-
Ten-year PPA	-	1,278	-
<b>Three Months Ended March 31, 2012:</b>			
Commodity derivative contracts	\$ -	\$ 1,928	\$ 3,090
FTRs	-	66	-
Ten-year PPA	-	-	-

MGE's commodity derivative contracts, FTRs, and ten-year PPA are subject to regulatory deferral. These derivatives are marked to fair value and are offset with a corresponding regulatory asset or liability. Realized gains and losses are deferred on the consolidated balance sheet and are recognized in earnings in the delivery month applicable to the instrument. As a result of the above described treatment, there are no unrealized gains or losses that flow through earnings.

The ten-year PPA has a provision that may require MGE to post collateral if MGE's debt rating falls below investment grade (i.e., below BBB-). The amount of collateral that it may be required to post varies from \$20.0 million to \$40.0 million, depending on MGE's nominated capacity amount. As of March 31, 2013, no collateral has been posted. Certain counterparties extend MGE a credit limit. If MGE exceeds these limits, the counterparties may require collateral to be posted. As of March 31, 2013, and December 31, 2012, no counterparties were in a net liability



position.

Nonperformance of counterparties to the non-exchange traded derivatives could expose MGE to credit loss. However, MGE enters into transactions only with companies that meet or exceed strict credit guidelines, and it monitors these counterparties on an ongoing basis to mitigate nonperformance risk in its portfolio. As of March 31, 2013, no counterparties have defaulted.

**10.**

**Rate Matters - MGE Energy and MGE.**

**a.**

**Rate Proceedings.**

On April 15, 2013, MGE applied with the PSCW for authority to freeze electric and natural gas rates at 2013 levels for 2014. The application includes a request for categorizing 100% of the cost of the Columbia scrubber construction project as AFUDC. The plan includes a request for deferral of increases in ATC and MISO Schedule 26 fees. In addition, MGE is requesting that approximately \$6.2 million pertaining to a fuel rule surplus credit be offset against MGE's increased costs. The fuel credit will accrue interest at MGE's weighted cost of capital during 2013, and the requested treatment of the credit will contribute to the overall rate freeze for 2014.

On December 14, 2012, the PSCW authorized MGE to increase 2013 rates for retail electric customers by 3.8% or \$14.9 million and to increase gas rates by 1.0% or \$1.6 million. The change in retail electric rates was driven by costs for new environmental equipment at Columbia, final construction costs for the Elm Road Units, transmission reliability enhancements, and purchased power costs. The authorized return on common stock equity remains unchanged at 10.3%.

On December 15, 2011, under a limited reopener of MGE's last rate order, the PSCW authorized MGE to increase 2012 rates for retail electric customers by 4.3% or \$15.7 million and to increase gas rates by 0.3% or \$0.6 million. The change in retail electric rates was driven by MGE's electric fuel and purchased power costs, increased transmission costs, an update to the Elm Road Units' costs, and an increase for energy efficiency programs. The PSCW also approved deferral of CSAPR costs.

**b.**

#### **Fuel Rules.**

Fuel rules require the PSCW and Wisconsin utilities to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band around the amount approved for a utility in its most recent base rate proceedings. Any over/under recovery of the actual costs is determined on an annual basis and will be adjusted in future billings to electric retail customers. The fuel rules bandwidth is currently set at plus or minus 2%. Under fuel rules, MGE would defer costs, less any excess revenues, if its actual electric fuel costs exceeded 102% of the electric fuel costs allowed in its latest rate order. Excess revenues are defined as revenues in the year in question that provide MGE with a greater return on common equity than authorized by the PSCW in MGE's latest rate order. Conversely, MGE is required to defer the benefit of lower costs if actual electric fuel costs were less than 98% of the electric fuel costs allowed in that order. As of March 31, 2013, MGE did not defer any electric fuel-related savings/costs that are outside the range authorized by the PSCW.

**c.**

#### **Purchased Gas Adjustment Clause.**

MGE's natural gas rates are subject to a fuel adjustment clause designed to recover or refund the difference between the actual cost of purchased gas and the amount included in rates. Differences between the amounts billed to customers and the actual costs recoverable are deferred and recovered or refunded in future periods by means of prospective monthly adjustments to rates. At March 31, 2013, MGE had over collected \$5.3 million, recorded in other current liabilities on the consolidated balance sheet. At December 31, 2012, MGE had under collected \$0.1 million, recorded in other current assets on the consolidated balance sheet.

**11.**

**Fair Value of Financial Instruments - MGE Energy and MGE.**

Fair value is defined as the price that would be received to sell an asset or would be paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability including assumptions about risk. The standard also establishes a three level fair value hierarchy based upon the observability of the assumptions used and requires the use of observable market data when available. The levels are:

Level 1 - Pricing inputs are quoted prices within active markets for identical assets or liabilities.

Level 2 - Pricing inputs are quoted prices within active markets for similar assets or liabilities; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations that are correlated with or otherwise verifiable by observable market data.

Level 3 - Pricing inputs are unobservable and reflect management's best estimate of what market participants would use in pricing the asset or liability.

a.

**Fair Value of Financial Assets and Liabilities Recorded at the Carrying Amount.**

At March 31, 2013, and December 31, 2012, the carrying amount of cash and cash equivalents approximates fair market value due to the short maturity of those investments and obligations. The estimated fair market value of MGE Energy's and MGE's long-term debt is based on quoted market prices for similar financial instruments at March 31, 2013, and December 31, 2012. Since the long-term debt is not traded in an active market, it is classified as Level 2. The estimated fair market value of MGE Energy's and MGE's financial instruments are as follows:

<i>(In thousands)</i>	March 31, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>MGE Energy</b>				
<i>Assets:</i>				
Cash and cash equivalents	\$ 45,894	\$ 45,894	\$ 46,357	\$ 46,357
<i>Liabilities:</i>				
Short-term debt - commercial paper	10,500	10,500	-	-
Long-term debt*	361,138	432,430	361,805	427,456
<b>MGE</b>				
<i>Assets:</i>				
Cash and cash equivalents	9,856	9,856	6,350	6,350
<i>Liabilities:</i>				
Short-term debt - commercial paper	10,500	10,500	-	-
Long-term debt*	361,138	432,430	361,805	427,456

\*Includes long-term debt due within one year.

b.

**Recurring Fair Value Measurements.**

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis for MGE Energy and MGE.

<i>(In thousands)</i>	Total	Fair Value as of March 31, 2013		
		Level 1	Level 2	Level 3
<b>MGE Energy</b>				
<i>Assets:</i>				

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Exchange-traded investments	\$ 428	\$ 428	\$ -	\$ -
Total Assets	\$ 428	\$ 428	\$ -	\$ -
Liabilities:				
Derivatives, net <sup>(a)</sup>	\$ 69,197	\$ (401)	\$ -	\$ 69,598
Deferred compensation	2,085	-	2,085	-
Total Liabilities	\$ 71,282	\$ (401)	\$ 2,085	\$ 69,598

**MGE**

Assets:

Exchange-traded investments	\$ 161	\$ 161	\$ -	\$ -
Total Assets	\$ 161	\$ 161	\$ -	\$ -

Liabilities:

Derivatives, net <sup>(a)</sup>	\$ 69,197	\$ (401)	\$ -	\$ 69,598
Deferred compensation	2,085	-	2,085	-
Total Liabilities	\$ 71,282	\$ (401)	\$ 2,085	\$ 69,598

(a) *These amounts are shown gross and exclude \$0.5 million of collateral that was posted against derivative positions with counterparties.*

<i>(In thousands)</i>	Fair Value as of December 31, 2012			
	Total	Level 1	Level 2	Level 3
<b>MGE Energy</b>				
Assets:				
Exchange-traded investments	\$ 320	\$ 320	\$ -	\$ -
Total Assets	\$ 320	\$ 320	\$ -	\$ -
Liabilities:				
Derivatives, net	\$ 72,329	\$ (17)	\$ -	\$ 72,346
Deferred compensation	2,010	-	2,010	-
Total Liabilities	\$ 74,339	\$ (17)	\$ 2,010	\$ 72,346
<b>MGE</b>				
Assets:				
Exchange-traded investments	\$ 117	\$ 117	\$ -	\$ -
Total Assets	\$ 117	\$ 117	\$ -	\$ -
Liabilities:				
Derivatives, net	\$ 72,329	\$ (17)	\$ -	\$ 72,346
Deferred compensation	2,010	-	2,010	-
Total Liabilities	\$ 74,339	\$ (17)	\$ 2,010	\$ 72,346

No transfers were made in or out of Level 1 or Level 2 for the three months ended March 31, 2013.

Investments include exchange-traded investment securities valued using quoted prices on active exchanges and are therefore classified as Level 1.

Derivatives include exchange-traded derivative contracts, over-the-counter transactions, a ten-year purchased power agreement, and FTRs. Most exchange-traded derivative contracts are valued based on unadjusted quoted prices in active markets and are therefore classified as Level 1. A small number of exchange-traded derivative contracts are valued using quoted market pricing in markets with insufficient volumes and are therefore classified as Level 3. Transactions done with an over-the-counter party are on inactive markets and are therefore classified as Level 3. These transactions are valued based on quoted prices from markets with similar exchange traded transactions. FTRs are priced based upon monthly auction results for identical or similar instruments in a closed market with limited data available and are therefore classified as Level 3.

The ten-year purchased power agreement (see Footnote 9) was valued using an internally-developed pricing model and therefore is classified as Level 3. The model projects future market energy prices and compares those prices to the projected power costs to be incurred under the contract. Inputs to the model require significant management judgment and estimation. Future energy prices are based on a forward power pricing curve using exchange-traded contracts in the electric futures market, where such exchange-traded contracts exist, and upon calculations based on forward gas prices, where such exchange-traded contracts do not exist. A basis adjustment is applied to the market energy price to

reflect the price differential between the market price delivery point and the counterparty delivery point. The historical relationship between the delivery points is reviewed and a discount (below 100%) or premium (above 100%) is derived. This comparison is done for both peak times when demand is high and off peak times when demand is low. If the basis adjustment is lowered, the fair value measurement will decrease and if the basis adjustment is increased, the fair value measurement will increase.

The projected power costs anticipated to be incurred under the purchased power agreement are determined using many factors, including historical generating costs, future prices, and expected fuel mix of the counterparty. An increase in the projected fuel costs would result in a decrease in the fair value measurement of the purchased power agreement. A significant input that MGE estimates is the counterparty's fuel mix in determining the projected power cost. MGE also considers the assumptions that market participants would use in valuing the asset or liability. This consideration includes assumptions about market risk such as liquidity, volatility, and contract duration. The fair value model uses a discount rate that incorporates discounting, credit, and model risks.

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This model is prepared by members of MGE's Energy Supply group. It is reviewed on a quarterly basis by management in Energy Supply and Finance to review the assumptions, inputs, and fair value measurements.

The following table presents the significant unobservable inputs used in the pricing model.

Significant Unobservable Inputs	Model Input
Basis adjustment:	
On peak	97.1 %
Off peak	96.0 %
Counterparty fuel mix:	
Internal generation	50 % - 70 %
Purchased power	50 % - 30 %

The deferred compensation plan allows participants to defer certain cash compensation into a notional investment account. These amounts are included within other deferred liabilities in the consolidated balance sheets of MGE Energy and MGE. The notional investments earn interest based upon the semiannual rate of U.S. Treasury Bills having a 26 week maturity increased by 1% compounded monthly with a minimum annual rate of 7%, compounded monthly. The notional investments are based upon observable market data, however, since the deferred compensation obligations themselves are not exchanged in an active market, they are classified as Level 2.

The following table summarizes the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for both MGE Energy and MGE.

<i>(In thousands)</i>	Three Months Ended	
	March 31,	
	2013	2012
Beginning balance,	\$ (72,346)	\$ (40,661)
Realized and unrealized gains (losses):		
Included in regulatory liabilities (assets)	2,748	(30,527)
Included in other comprehensive income	-	-
Included in earnings	(1,148)	(1,502)
Included in current assets	-	(50)
Purchases	5,562	50
Sales	(3)	31
Issuances	-	-
Settlements	(4,411)	1,471
Transfers in and/or out of Level 3	-	-
Balance as of March 31,	\$ (69,598)	\$ (71,188)
Total gains (losses) included in earnings attributed to the change in unrealized gains (losses) related to assets and liabilities held at March 31, <sup>(b)</sup>	\$ -	\$ -



The following table presents total realized and unrealized gains (losses) included in income for Level 3 assets and liabilities measured at fair value on a recurring basis for both MGE Energy and MGE (b).

<i>(In thousands)</i>	Three Months Ended	
	March 31,	
	2013	2012
Purchased Power Expense	\$ (1,148)	\$ (1,502)
Cost of Gas Sold Expense	-	-
Regulated Gas Revenues	-	-
Total	\$ (1,148)	\$ (1,502)

*(b) MGE's exchange-traded derivative contracts, over-the-counter party transactions, ten-year purchased power agreement, and FTRs are subject to regulatory deferral. These derivatives are therefore marked to fair value and are offset with a corresponding regulatory asset or liability.*

12.

**New Accounting Pronouncements - MGE Energy and MGE.**

a.

**Presentation of Comprehensive Income.**

In February 2013, the FASB issued authoritative guidance within the Codification's Comprehensive Income topic that provides guidance on the reporting of amounts reclassified out of accumulated other comprehensive income. Reclassification adjustments will be presented either on the financial statement where income is presented or as a separate disclosure in the notes to the financial statements. This authoritative guidance became effective January 1, 2013. The authoritative guidance had no effect on our financial statement presentation or notes to the financial statements.

b.

**Disclosures about Offsetting Assets and Liabilities.**

In December 2011, the FASB issued authoritative guidance within the Codification's Balance Sheet topic that provides guidance on disclosures about offsetting assets and liabilities. The new disclosure requirements mandate that entities disclose both gross and net information for instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions subject to a master netting arrangement. In addition, the standard requires disclosure of collateral received and posted in connections with a master netting arrangement. On January 31, 2013, the FASB issued additional authoritative guidance which clarified the scope of disclosures about offsetting assets and liabilities. The revised guidance limits the scope of the new balance sheet offsetting disclosures to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement. This authoritative guidance became effective January 1, 2013. The authoritative guidance did not have a financial impact, but required additional disclosures. See Footnote 9 for additional information.

c.

**Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date.**

In February 2013, the FASB issued authoritative guidance within the Codification's Balance Sheet topic that provides guidance on the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. This authoritative guidance

will become effective January 1, 2014. The authoritative guidance will not have a financial or disclosure impact.

13.

**Segment Information - MGE Energy and MGE.**

MGE Energy operates in the following business segments: electric utility, gas utility, nonregulated energy, transmission investment, and all other. See MGE Energy's and MGE's 2012 Annual Report on Form 10-K for additional discussion of each of these segments.

The following tables show segment information for MGE Energy's operations for the indicated periods:

<i>(In thousands)</i>			Non-	Consolidation/			
			Regulated	Transmission	All	Elimination	Consolidated
<b>MGE Energy</b>	Electric	Gas	Energy	Investment	Others	Entries	Total
<b><i>Three Months Ended March 31, 2013</i></b>							
Operating revenues	\$ 93,494	\$ 72,467	\$ 1,276	\$ -	\$ -	\$ -	167,237
Interdepartmental revenues	109	4,876	10,573	-	-	(15,558)	-
Total operating revenues	93,603	77,343	11,849	-	-	(15,558)	167,237
Depreciation and amortization	(6,400)	(1,425)	(1,799)	-	-	-	(9,624)
Other operating expenses	(74,925)	(60,437)	(37)	-	(144)	15,558	(119,985)
Operating income (loss)	12,278	15,481	10,013	-	(144)	-	37,628
Other income, net	575	162	-	2,396	176	-	3,309
Interest (expense) income, net	(2,404)	(678)	(1,613)	-	20	-	(4,675)
Income before taxes	10,449	14,965	8,400	2,396	52	-	36,262
Income tax provision	(3,433)	(5,989)	(3,257)	(971)	(28)	-	(13,678)
Net income	\$ 7,016	\$ 8,976	\$ 5,143	\$ 1,425	\$ 24	\$ -	22,584
<b><i>Three Months Ended March 31, 2012</i></b>							
Operating revenues	\$ 89,936	\$ 57,019	\$ 2,304	\$ -	\$ -	\$ -	149,259
Interdepartmental revenues	109	2,986	8,676	-	-	(11,771)	-
Total operating revenues	90,045	60,005	10,980	-	-	(11,771)	149,259
Depreciation and amortization	(6,478)	(1,370)	(1,776)	-	-	-	(9,624)

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Other operating expenses	(72,788)	(49,741)	(12)	-	(421)	11,771	(111,191)
Operating income (loss)	10,779	8,894	9,192	-	(421)	-	28,444
Other income, net	164	46	-	2,242	118	-	2,570
Interest (expense) income, net	(2,727)	(769)	(1,645)	-	37	-	(5,104)
Income (loss) before taxes	8,216	8,171	7,547	2,242	(266)	-	25,910
Income tax (provision) benefit	(2,785)	(3,238)	(3,029)	(910)	100	-	(9,862)
Net income (loss)	\$ 5,431	\$ 4,933	\$ 4,518	\$ 1,332	\$ (166)	\$ -	\$ 16,048

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The following tables show segment information for MGE's operations for the indicated periods:

<i>(In thousands)</i>	Non-			Consolidation/		Consolidated
	Regulated	Transmission	Energy	Investment	Elimination	
<b>MGE</b>	Electric	Gas	Energy	Investment	Entries	Total
<b>Three Months Ended</b>						
<b>March 31, 2013</b>						
Operating revenues	\$ 93,494	\$ 72,467	\$ 1,276	\$ -	\$ -	\$ 167,237
Interdepartmental revenues	109	4,876	10,573	-	(15,558)	-
Total operating revenues	93,603	77,343	11,849	-	(15,558)	167,237
Depreciation and amortization	(6,400)	(1,425)	(1,799)	-	-	(9,624)
Other operating expenses*	(78,506)	(66,468)	(3,294)	-	15,558	(132,710)
Operating income*	8,697	9,450	6,756	-	-	24,903
Other income, net*	723	204	-	1,425	-	2,352
Interest expense, net	(2,404)	(678)	(1,613)	-	-	(4,695)
Net income	7,016	8,976	5,143	1,425	-	22,560
Less: Net income attributable to noncontrolling interest, net of tax	-	-	-	-	(6,826)	(6,826)
Net income attributable to MGE	\$ 7,016	\$ 8,976	\$ 5,143	\$ 1,425	\$ (6,826)	\$ 15,734
<b>Three Months Ended</b>						
<b>March 31, 2012</b>						
Operating revenues	\$ 89,936	\$ 57,019	\$ 2,304	\$ -	\$ -	\$ 149,259
Interdepartmental revenues	109	2,986	8,676	-	(11,771)	-
Total operating revenues	90,045	60,005	10,980	-	(11,771)	149,259
Depreciation and amortization	(6,478)	(1,370)	(1,776)	-	-	(9,624)
Other operating expenses*	(75,508)	(52,961)	(3,041)	-	11,771	(119,739)
Operating income*	8,059	5,674	6,163	-	-	19,896
Other income, net*	99	28	-	1,332	-	1,459
Interest expense, net	(2,727)	(769)	(1,645)	-	-	(5,141)
Net income	5,431	4,933	4,518	1,332	-	16,214
Less: net income attributable to noncontrolling interest, net of tax	-	-	-	-	(6,072)	(6,072)
	\$ 5,431	\$ 4,933	\$ 4,518	\$ 1,332	\$ (6,072)	\$ 10,142

Net income  
attributable to MGE

\*Amounts are shown net of the related tax expense, consistent with the presentation on the consolidated MGE Income Statement.

The following table shows segment information for MGE Energy's and MGE's assets and capital expenditures:

	Utility		Assets			Consolidated Consolidation/			Total
	Electric	Gas	not Allocated	Nonregulated Energy	Transmission Investment	All Others	Elimination Entries		
<i>(In thousands)</i>									
<b>MGE Energy</b>									
<i>Assets:</i>									
March 31, 2013	\$904,578	\$275,815	\$ 11,900	\$ 324,894	\$ 61,826	\$409,602	\$ (408,175)	\$1,580,440	
December 31, 2012	888,444	285,468	18,559	323,216	61,064	413,291	(403,118)	1,586,924	
<i>Capital Expenditures:</i>									
Three Months Ended									
March 31, 2013	\$ 27,007	\$ 1,689	\$ -	\$ 468	\$ -	\$ -	\$ -	\$ 29,164	
Year ended Dec. 31, 2012	81,965	13,812	-	2,658	-	-	-	98,435	

	Utility		Assets			Consolidated			Total
	Electric	Gas	not Allocated	Nonregulated Energy	Transmission Investment	Elimination Entries			
<i>(In thousands)</i>									
<b>MGE</b>									
<i>Assets:</i>									
March 31, 2013	\$904,578	\$275,815	\$ 11,900	\$ 324,844	\$ 61,826	\$ (28,358)	\$1,550,605		
December 31, 2012	888,444	285,468	18,559	323,166	61,064	(23,050)	1,553,651		
<i>Capital Expenditures:</i>									
Three Months Ended March 31,									
2013	\$ 27,007	\$ 1,689	\$ -	\$ 468	\$ -	\$ -	\$ 29,164		
Year ended Dec. 31, 2012	81,965	13,812	-	2,658	-	-	98,435		





**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*General*

MGE Energy is an investor-owned public utility holding company operating through subsidiaries in five business segments:

.

Regulated electric utility operations, conducted through MGE,

.

Regulated gas utility operations, conducted through MGE,

.

Nonregulated energy operations, conducted through MGE Power and its subsidiaries,

.

Transmission investments, representing our equity investment in ATC, and

.

All other, which includes corporate operations and services.

Our principal subsidiary is MGE, which generates and distributes electric energy, distributes natural gas, and represents a majority portion of our assets, liabilities, revenues, and expenses. MGE generates and distributes electricity to approximately 140,000 customers in Dane County, Wisconsin, including the city of Madison, and purchases and distributes natural gas to approximately 145,000 customers in the Wisconsin counties of Columbia, Crawford, Dane, Iowa, Juneau, Monroe, and Vernon.

Our nonregulated energy operations own interests in electric generating capacity that is leased to MGE. The ownership/leasing structure was adopted under applicable state regulatory guidelines for MGE's participation in these generation facilities, consisting principally of a stable return on the equity investment in the new generation facilities over the term of the related leases. The nonregulated energy operations include an ownership interest in two coal-fired generating units in Oak Creek, Wisconsin and a partial ownership of a cogeneration project on the UW-Madison campus. A third party operates the units in Oak Creek, and MGE operates the cogeneration project. Due to the nature of MGE's participation in these facilities, the results of our nonregulated operations are also consolidated into MGE's consolidated financial position and results of operations under applicable accounting standards.

*Overview*

Our primary focus today and for the foreseeable future is our core utility customers at MGE as well as creating long-term value for our shareholders. MGE continues to face the challenge of providing its customers with reliable power at competitive prices. MGE meets this challenge by investing in more efficient generation projects, including renewable energy sources. In the future, MGE will continue to focus on growing earnings while controlling operating and fuel costs. MGE will continue to maintain safe and efficient operations in addition to providing customer value. We believe it is critical to maintain a strong credit standing consistent with financial strength in MGE as well as the parent company in order to accomplish these goals.

We earn our revenue and generate cash from operations by providing electric and natural gas utility services, including electric power generation and electric power and gas distribution. The earnings and cash flows from the utility business are sensitive to various external factors, including:

.

Weather, and its impact on customer sales of electricity and gas,

.

Economic conditions, including current business activity and employment and their impact on customer demand,

.

Regulation and regulatory issues, and their impact on the timing and recovery of costs,

.

Energy commodity prices,

.

Equity price risk pertaining to pension related assets,

.

Credit market conditions, including interest rates and our debt credit rating,

.

Environmental laws and regulations, including adopted and pending environmental rule changes,

.

Construction risk in connection with the Columbia environmental project,

and other factors listed in "Item 1A. Risk Factors" in our 2012 Annual Report on Form 10-K.

For the three months ended March 31, 2013, MGE Energy's earnings were \$22.6 million or \$0.98 per share compared to \$16.0 million or \$0.69 per share for the same period in the prior year. MGE's earnings for the three months ended March 31, 2013, were \$15.7 million compared to \$10.1 million for the same period in the prior year.

MGE Energy's income was derived from our business segments as follows:

<i>(In thousands)</i>	Three Months Ended	
	2013	March 31, 2012
Business Segment:		
Electric Utility	\$ 7,016	\$ 5,431
Gas Utility	8,976	4,933
Nonregulated Energy	5,143	4,518
Transmission Investments	1,425	1,332
All Other	24	(166)
Net Income	\$ 22,584	\$ 16,048

Our net income during the three months ended March 31, 2013, primarily reflects the effects of the following factors:

A 4.5% increase in retail electric revenues, driven by a 6.9% increase in residential customer demand.

A 31.8% increase in gas sales reflecting higher customer demand due to a colder winter compared to the same period in the prior year. Heating degree days (a measure for determining the impact of weather during the heating season) increased by 38% compared to the prior period.

During the first three months of 2013, the following events occurred:

**Columbia Environmental Project:** In early 2011, the PSCW authorized the construction of air emission reduction systems and associated equipment on Columbia Units 1 and 2. MGE's estimated share of the capital expenditures required to complete this project will be approximately \$140 million. As of March 31, 2013, MGE has accumulated \$78.8 million (excluding carrying costs) related to its share of the project, which is reflected in the Construction Work in Progress balance on MGE Energy's and MGE's consolidated balance sheets. Of this amount, MGE has accumulated \$18.8 million in 2013. MGE has recognized \$0.5 million (after tax) in AFUDC equity related to this project for the three months ended March 31, 2013.

**Smart Grid Investment Grant:** MGE was approved in 2010 by the U.S. Department of Energy (DOE) under the federal stimulus program for a \$5.5 million grant for smart grid projects. The DOE grant requires MGE to match the grant funding, bringing the total cost of the projects to more than \$11 million. The projects involve the installation of

technologies to boost efficiency, enhance service, and improve reliability for customers. The stimulus grant is being used to fund the following projects: advanced metering infrastructure, plug-in hybrid electric vehicles support, and distribution management. As of March 31, 2013, MGE has spent \$9.6 million related to these projects. Of this amount, \$1.2 million was incurred during the three months ended March 31, 2013. MGE also has outstanding agreements to purchase \$0.9 million in smart grid related products for the remainder of 2013.

In the near term, several items may affect us, including:

**Rate Filing:** On April 15, 2013, MGE applied with the PSCW for authority to freeze electric and natural gas rates at 2013 levels for 2014. The application includes a request for categorizing 100% of the cost of the Columbia scrubber construction project as AFUDC. The plan includes a request for deferral of increases in ATC and MISO Schedule 26 fees. In addition, MGE is requesting that approximately \$6.2 million pertaining to a fuel rule surplus credit be offset against MGE's increased costs. The fuel credit will accrue interest at MGE's weighted cost of capital during 2013, and the requested treatment of the credit will contribute to the overall rate freeze for 2014.

**Environmental Initiatives:** There are proposed legislation, rules, and initiatives involving matters related to air emissions, water effluent, hazardous materials, and greenhouse gases, all of which affect generation plant capital expenditures and operating costs as well as future operational planning. Such legislation and rulemaking could significantly affect the costs of owning and operating fossil-fueled generating plants, such as Columbia and Elm Road, from which we derive approximately 43% of our electric generating capacity. We would expect to seek and receive recovery of any such costs in rates; however, it is difficult to estimate the amount of such costs due to the uncertainty as to the timing and form of the legislation and rules, and the scope and time of the recovery of costs in rates. In addition, MGE is involved in claims surrounding the alleged failure, among other things, to obtain necessary air permits and implement necessary emission controls associated with past activities at Columbia. MGE and the other co-owners are defending against these claims. See Columbia discussion in Footnote 8.a. in Notes to Consolidated Financial Statements.

Columbia Environmental Project: MGE's share of the capital expenditures associated with the Columbia environmental project will be approximately \$49 million for the remainder of 2013 million and \$12 million in 2014. We intend to fund any remaining capital commitments with funds generated from normal operations and the issuance of long-term and short-term debt.

General economic conditions: Economic conditions both inside and outside our service area are expected to continue to affect the level of demand for our utility services and may affect the collection of our accounts receivable and the creditworthiness of counterparties with whom we do business. We have in place lines of credit aggregating \$104.5 million for MGE Energy (including MGE) and \$64.5 million for MGE to address our liquidity needs.

The following discussion is based on the business segments as discussed in Footnote 13.

### *Three Months Ended March 31, 2013 and 2012*

#### **Electric Utility Operations - MGE Energy and MGE**

##### *Electric sales and revenues*

The following table compares MGE's electric revenues and electric kWh sales by customer class for each of the periods indicated:

<i>(in thousands)</i>	Revenues			Sales (kWh)		
	Three Months Ended March 31,			Three Months Ended March 31,		
	2013	2012	% Change	2013	2012	% Change
Residential	\$ 33,574	\$ 30,139	11.4 %	209,782	196,163	6.9 %
Commercial	48,147	47,196	2.0 %	429,359	431,755	(0.6)%
Industrial	4,531	4,526	0.1 %	59,187	59,848	(1.1)%
Other-retail/municipal	8,639	8,974	(3.7)%	97,538	107,680	(9.4)%
Total retail	94,891	90,835	4.5 %	795,866	795,446	0.1 %
Sales to the market	19	280	(93.2)%	10,146	5,788	75.3 %
Adjustments to revenues	(1,416)	(1,179)	(20.1)%	-	-	- %
Total	\$ 93,494	\$ 89,936	4.0 %	806,012	801,234	0.6 %

Electric operating revenues increased \$3.6 million or 4.0% for the three months ended March 31, 2013, due to the following:

<i>(In millions)</i>	
Rate changes	\$ 4.0
Sales to the market	(0.2)
Adjustments to revenues	(0.2)
Total	\$ 3.6

*Rate changes.* Rates charged to retail customers for the three months ended March 31, 2013, were 4.4% or \$4.0 million higher than those charged during the same period in the prior year.

In December 2012, the PSCW authorized MGE to increase 2013 rates for retail electric customers by 3.8% or \$14.9 million. The increase in retail electric rates is driven by costs for new environmental equipment at Columbia, final construction costs for the Elm Road Units, transmission reliability enhancements, and purchased power costs.

*Sales to the market.* Sales to the market represent wholesale sales made to third parties who are not ultimate users of the electricity. These sales may include spot market transactions on the markets operated by MISO and PJM. These sales may also include bilateral sales to other utilities or power marketers. Generating Units are dispatched by MISO based on cost considerations as well as reliability of the system. Sales to the market typically occur when MGE has more generation and purchases online than is needed for its own system demand. The excess electricity is then sold to others in the market. For the three months ended March 31, 2013, market volumes increased compared to the same period in the prior year, reflecting increased opportunities for sales; however, market settlement resulted in lower revenue per kWh for the three months ended March 31, 2013, reflecting lower market prices.

*Adjustments to revenues.* The adjustments to revenues amount includes the elimination of carrying costs for the Elm Road Units and WCCF that were collected in electric rates, which are recognized as nonregulated energy operating revenues in our Nonregulated Energy Operations segment.

***Electric fuel and purchased power***

The expense for fuel for electric generation increased \$1.9 million or 21.6% during the three months ended March 31, 2013, compared to the same period in the prior year. Internal electric generated volume delivered to the system increased 35.4% which resulted in \$2.8 million of increased expense, reflecting higher generation at Columbia. This increase was offset by a decrease in internal electric generation costs of \$0.9 million as a result of a 10.2% decrease in the per-unit cost (largely due to lower natural gas prices).

Purchased power expense decreased \$1.3 million during the three months ended March 31, 2013, compared to the same period in the prior year. A 29.4% decrease in the volume of purchased power from third parties lowered expense by \$5.7 million, which was offset by a \$4.4 million or 31.9% increase in the per-unit cost of purchased power.

***Electric operating and maintenance expenses***

Electric operating and maintenance expenses decreased \$0.4 million during the three months ended March 31, 2013, compared to the same period in 2012. The following changes contributed to the net change:

<i>(In millions)</i>	
Decreased administrative and general costs	\$ (0.7)
Decreased customer service costs	(0.3)
Decreased other costs	(0.1)
Increased transmission costs	0.7
Total	\$ (0.4)

For the three months ended March 31, 2013, decreased administrative and general costs are primarily due to decreased pension costs and increased transmission costs are primarily due to an increase in transmission reliability enhancements.

**Gas Utility Operations - MGE Energy and MGE**



**Gas deliveries and revenues**

The following table compares MGE's gas revenues and gas therms delivered by customer class during each of the periods indicated:

<i>(In thousands, except HDD and average rate per therm of retail customer)</i>	Revenues			Therms Delivered		
	Three Months Ended March 31,			Three Months Ended March 31,		
	2013	2012	% Change	2013	2012	% Change
Residential	\$ 41,611	\$ 33,381	24.7 %	47,454	35,600	33.3 %
Commercial/Industrial	29,771	22,771	30.7 %	49,211	36,947	33.2 %
Total retail	71,382	56,152	27.1 %	96,665	72,547	33.2 %
Gas transportation	943	729	29.4 %	12,327	10,117	21.8 %
Other revenues	142	138	2.9 %	-	-	- %
Total	\$ 72,467	\$ 57,019	27.1 %	108,992	82,664	31.8 %
Heating degree days (normal 3,488)				3,745	2,717	37.8 %
Average rate per therm of retail customer	\$ 0.738	\$ 0.774	(4.7)%			

Gas revenues increased \$15.4 million or 27.1% for the three months ended March 31, 2013. These changes are related to the following factors:

<i>(In millions)</i>	
Gas deliveries	\$ 18.7
Transportation and other effects	0.1
Gas costs/rates	(3.4)
Total	\$ 15.4

*Retail gas deliveries.* For the three months ended March 31, 2013, retail gas deliveries increased 33.2% compared to the same period in 2012 as a result of colder weather during the winter months compared to milder weather in the prior year.

*Gas costs/rates.* The average retail rate per therm for the three months ended March 31, 2013, decreased 4.7% compared to the same period in 2012, reflecting lower natural gas commodity costs.

### ***Cost of gas sold***

For the three months ended March 31, 2013, cost of gas sold increased by \$9.8 million, compared to the same period in the prior year. The volume of gas purchased increased 33.0%, which resulted in \$11.4 million of increased expense. However, the cost per therm of natural gas decreased 3.5%, which resulted in \$1.6 million of decreased expense.

### ***Gas operating and maintenance expenses***

Gas operating and maintenance expenses decreased by \$0.7 million for the three months ended March 31, 2013, compared to the same period in 2012. The following changes contributed to the net change:

<i>(In millions)</i>	
Decreased administrative and general costs	\$ (0.3)
Decreased customer service costs	(0.3)
Decreased customer accounts costs	(0.1)
Total	\$ (0.7)

**Nonregulated Energy Operations - MGE Energy and MGE**

For the three months ended March 31, 2013 and 2012, net income at the nonregulated energy operations segment was \$5.1 million and \$4.5 million, respectively. The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power Elm Road and MGE Power West Campus. These subsidiaries have been formed to construct, own and lease electric generating capacity to assist MGE.

**Transmission Investment Operations - MGE Energy and MGE**

*Transmission investment other income*

For the three months ended March 31, 2013, other income at the transmission investment segment was \$2.4 million compared to \$2.2 million for the same period in 2012. The transmission investment segment holds our interest in ATC, and its income reflects our equity in the earnings of ATC. See Footnote 3 for additional information concerning ATC and summarized financial information regarding ATC.

**Consolidated Income Taxes - MGE Energy and MGE**

MGE Energy's and MGE's effective income tax rate for the three months ended March 31, 2013, was 37.7% compared to 38.1% for the same period in 2012.

**Noncontrolling Interest, Net of Tax - MGE**

The noncontrolling interest, net of tax, reflects the accounting required for MGE Energy's interest in MGE Power Elm Road (the Elm Road Units) and MGE Power West Campus (WCCF). MGE Energy owns 100% of MGE Power Elm Road and MGE Power West Campus; however, due to the contractual agreements for these projects with MGE, the entities are considered VIEs and their results are consolidated with those of MGE, the primary beneficiary of the VIEs. Also included in noncontrolling interest, net of tax, is MGE Energy's interest in MGE Transco. The following table shows MGE Energy's noncontrolling interest, net of tax, reflected on MGE's consolidated statement of income:

	Three Months Ended	
	March 31,	
<i>(in millions)</i>	2013	2012
MGE Power Elm Road	\$ 4.3	\$ 3.7
MGE Power West Campus	\$ 1.9	\$ 1.9
MGE Transco	\$ 0.6	\$ 0.5

**Contractual Obligations and Commercial Commitments - MGE Energy and MGE**

There were no material changes, other than from the normal course of business, to MGE Energy's and MGE's contractual obligations (representing cash obligations that are considered to be firm commitments) and commercial commitments (representing commitments triggered by future events) during the three months ended March 31, 2013, except as noted below. Further discussion of the contractual obligations and commercial commitments is included in Footnote 8 of this Report and Footnote 18 and "Contractual Obligations and Commercial Commitments for MGE Energy and MGE" under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in MGE Energy's and MGE's 2012 Annual Report on Form 10-K.

***Purchase Contracts - MGE Energy and MGE***

See Footnote 8.d. for a description of commitments at March 31, 2013, that MGE Energy and MGE have entered with respect to various commodity supply, transportation and storage contracts to meet their obligations to deliver electricity and natural gas to customers.

***Smart Grid Investment Grant - MGE Energy and MGE***

See Footnote 8.e. for a description of MGE's commitments and expenditures related to a grant received from the U.S. Department of Energy (DOE) under the federal stimulus program for smart grid projects.

### *Liquidity and Capital Resources*

#### **Cash Flows**

The following summarizes cash flows for MGE Energy and MGE during the three months ended March 31, 2013 and 2012:

<i>(In thousands)</i>	MGE Energy		MGE	
	2013	2012	2013	2012
Cash provided by/(used for):				
Operating activities	\$ 28,652	\$ 24,736	\$ 28,521	\$ 23,583
Investing activities	(29,816)	(15,716)	(29,526)	(15,773)
Financing activities	701	(9,529)	4,511	(7,049)

#### **Cash Provided by Operating Activities**

##### *MGE Energy*

MGE Energy's consolidated net cash provided by operating activities is derived mainly from the electric and gas operations of its principal subsidiary, MGE.

Cash provided by operating activities for the three months ended March 31, 2013, was \$28.7 million, an increase of \$3.9 million when compared to the same period in the prior year primarily related to working capital changes.

MGE Energy's net income increased \$6.5 million for the three months ended March 31, 2013, when compared to the same period in the prior year.

The cash flows for the three months ended March 31, 2013, reflect a \$2.4 million benefit of lower taxes payable, compared to the same period in the prior year, primarily due to bonus depreciation and repairs deduction.

Working capital accounts resulted in \$12.8 million in cash provided by operating activities for the three months ended March 31, 2013, primarily due to decreased gas inventories, decreased prepaid taxes, and decreased unbilled revenues, partially offset by increased accounts receivable and decreased accounts payable. Working capital accounts resulted in \$5.7 million in cash provided by operating activities for the three months ended March 31, 2012, primarily due to decreased gas inventories and decreased unbilled receivables, partially offset by decreased accounts payable.

An increase in pension contribution resulted in an additional \$10.0 million in cash used for operating activities for the three months ended March 31, 2013, when compared to the same period in the prior year. These contributions reflect amounts required by law and discretionary amounts.

### ***MGE***

Cash provided by operating activities for the three months ended March 31, 2013, was \$28.5 million, an increase of \$4.9 million when compared to the same period in the prior year primarily related to working capital changes.

Net income increased \$6.3 million for the three months ended March 31, 2013, when compared to the same period in the prior year.

The cash flows for the three months ended March 31, 2013, reflect a \$2.2 million benefit of lower taxes payable, compared to the same period in the prior year, primarily due to bonus depreciation and repairs deduction.

Working capital accounts resulted in \$12.8 million in cash provided by operating activities for the three months ended March 31, 2013, primarily due to decreased gas inventories, decreased prepaid taxes, and decreased unbilled revenues, partially offset by increased accounts receivable and decreased accounts payable. Working capital accounts resulted in

\$4.6 million in cash provided by operating activities for the three months ended March 31, 2012, primarily due to decreased gas inventories and decreased unbilled receivables, partially offset by decreased accounts payable.

An increase in pension contribution resulted in an additional \$10.0 million in cash used for operating activities for the three months ended March 31, 2013, when compared to the same period in the prior year. These contributions reflect amounts required by law and discretionary amounts.

### **Cash Used for Investing Activities**

#### ***MGE Energy***

MGE Energy's cash used for investing activities increased \$14.1 million for the three months ended March 31, 2013, when compared to the same period in the prior year.

Capital expenditures for the three months ended March 31, 2013, were \$29.2 million. This amount represents an increase of \$13.7 million from the expenditures made in the same period in the prior year. This increase is due to increased expenditures on the Columbia environmental project of \$10.8 million.

#### ***MGE***

MGE's cash used for investing activities increased \$13.8 million for the three months ended March 31, 2013, when compared to the same period in the prior year.

Capital expenditures for the three months ended March 31, 2013, were \$29.2 million. This amount represents an increase of \$13.7 million from the expenditures made in the same period in the prior year. This increase is due to increased expenditures on the Columbia environmental project of \$10.8 million.

**Cash Provided by (Used for) Financing Activities**

***MGE Energy***

Cash provided by MGE Energy's financing activities was \$0.7 million for the three months ended March 31, 2013, compared to \$9.5 million of cash used for the three months ended March 31, 2012.

For the three months ended March 31, 2013, dividends paid were \$9.1 million compared to \$8.8 million in the prior year. This increase was a result of a higher dividend per share (\$0.395 vs. \$0.383).

During the three months ended March 31, 2013, net short-term debt borrowings were \$10.5 million.

***MGE***

During the three months ended March 31, 2013, cash provided by MGE's financing activities was \$4.5 million compared to \$7.0 million of cash used for MGE's financing activities in the prior year.

Dividends paid from MGE to MGE Energy were \$6.7 million for the three months ended March 31, 2012.

During the three months ended March 31, 2013, net short-term debt borrowings were \$10.5 million.

Distributions to parent from noncontrolling interest were \$5.5 million for the three months ended March 31, 2013.

**Capitalization Ratios**

MGE Energy's capitalization ratios were as follows:



	MGE Energy	
	March 31, 2013	December 31, 2012
Common shareholders' equity	61.5 %	61.6 %
Long-term debt*	37.4 %	38.4 %
Short-term debt	1.1 %	- %

\*Includes the current portion of long-term debt.

### **MGE Energy's and MGE's Capital Requirements**

MGE Energy's and MGE's liquidity are primarily affected by their capital requirements. During the three months ended March 31, 2013, capital expenditures for MGE Energy and MGE totaled \$29.2 million, which included \$28.7 million of capital expenditures for utility operations.

In early 2011, the PSCW authorized the construction of air emission reduction systems and associated equipment on Columbia Units 1 and 2. MGE's estimated share of the capital expenditures required to complete this project will be approximately \$140 million. MGE's share of the capital expenditures associated with the Columbia environmental project will be approximately \$49 million for the remainder of 2013 and \$12 million in 2014. During the three months ended March 31, 2013, MGE had incurred \$18.8 million (excluding carrying costs) in construction expenditures at Columbia related to the project. MGE has recognized \$0.5 million (after tax) in AFUDC equity related to this project for the three months ended March 31, 2013.

### **Credit Ratings**

MGE Energy's and MGE's access to the capital markets, including, in the case of MGE, the commercial paper market, and their respective financing costs in those markets, may depend on the credit ratings of the entity that is accessing the capital markets.

None of MGE Energy's or MGE's borrowing is subject to default or prepayment as a result of a downgrading of credit ratings, although a downgrading of MGE's credit ratings could increase fees and interest charges under both MGE Energy's and MGE's credit agreements.

## Environmental Matters

The following discussion is limited to updates or developments in environmental matters that occurred during the three months ended March 31, 2013. Further discussion of environmental matters is included in MGE Energy's and MGE's 2012 Annual Report on Form 10-K and Footnote 8.a. of Notes to Consolidated Financial Statements in this Report.

### *Vacation of EPA's Cross State Air Pollution Rule (CSAPR) and Reinstatement of the Clean Air Interstate Rule (CAIR)*

In 2005, EPA promulgated the Clean Air Interstate Rule (CAIR) to reduce ozone and fine particulate matter emissions by reducing nitrogen oxide (NO<sub>x</sub>) and sulfur dioxide (SO<sub>2</sub>) emissions. NO<sub>x</sub> and SO<sub>2</sub> interact in the atmosphere to form ambient ozone from NO<sub>x</sub> and fine particulate matter pollution from NO<sub>x</sub> and SO<sub>2</sub>. The CAIR generally requires NO<sub>x</sub> and SO<sub>2</sub> emission reductions from fossil fuel-fired EGUs (25 MW or greater) in the eastern half of the United States in two phases and includes a regional cap-and-trade system. The first phase (currently in place) requires annual regional emission reductions from 2003 levels of 55% for NO<sub>x</sub> and 40% for SO<sub>2</sub>. The second phase (beginning in 2015) reduces regional NO<sub>x</sub> and SO<sub>2</sub> emissions further from 2003 levels to 65% and 70%, respectively. MGE owns or has partial ownership in several generation units currently subject to the CAIR: Blount, Columbia, Elm Road Units, and its combustion turbines located in West Marinette and Fitchburg.

In December 2008, the U.S. Court of Appeals for the D.C. Circuit remanded the CAIR to the EPA with directions to revise or replace the rule. The Court's remand order directed that the CAIR remain in effect until the EPA promulgated a replacement rule. The Court's order did not include a deadline for the EPA to act.

In August 2011, the EPA responded to the remand of the CAIR by promulgating the Cross State Air Pollution Rule (CSAPR). However, in August 2012, the U.S. Court of Appeals for the D.C. Circuit vacated CSAPR and instructed the EPA to continue administering the CAIR pending finalizing a valid alternative program to control interstate pollution. In January 2013, the U.S. Court of Appeals for the D.C. Circuit denied the EPA's petition for reconsideration *en banc*. The EPA and several environmental groups have appealed the D.C. Circuit Court's August 2012 decision to the Supreme Court in separate filings. At this time, the CAIR remains effective.

MGE is currently in compliance with the CAIR Phase I requirements. MGE will be able to meet Phase II NO<sub>x</sub> emissions reductions through using our NO<sub>x</sub> allowances provided through the rule, and we will meet Phase II SO<sub>2</sub> emissions reductions through installation of pollution controls. New SO<sub>2</sub> controls at Columbia are already underway and are planned to be completed by mid 2014. MGE expects that any costs incurred to meet Phase II of the CAIR will be fully recoverable through rates. MGE will monitor the Supreme Court's response to the CSAPR appeals and any subsequent actions by the EPA to continue to evaluate potential impacts to our operations.

### *Columbia*

Columbia is a coal-fired generating station operated by WPL in which WPL, WPSC, and MGE have ownership interests. In December 2009, the EPA sent a Notice of Violation (NOV) to MGE as one of the co-owners of Columbia. The NOV alleges that WPL and the Columbia co-owners failed to comply with appropriate pre-construction review and permitting requirements and, as a result, violated the Prevention of Significant Deterioration program requirements, Title V Operating Permit requirements of the CAA, and the Wisconsin SIP. In September 2010, the Sierra Club filed a civil lawsuit against WPL alleging violations of the CAA at Columbia and other Wisconsin facilities operated by WPL. In April 2013, WPL, as operator, along with the other owners of Columbia (MGE and WPS), entered into a consent decree with the EPA and the Sierra Club to resolve these claims, while admitting no liability. One of the requirements of the consent decree requires installation of a SCR system at Columbia Unit 2 by December 31, 2018. Based on a preliminary estimate received by WPL, MGE's share of the projected cost for construction of the SCR system at Columbia is approximately \$50-\$60 million. The consent decree has been lodged with, and is subject to approval by, the Court, which could occur in the second quarter of 2013. See Footnote 8.a. for additional information regarding these matters.

### **New Accounting Principles**

See Footnote 12 for discussion of new accounting pronouncements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

MGE Energy and MGE are potentially exposed to market risk associated with interest rates, commodity prices, and equity returns. MGE currently has no exposure to foreign currency risk. MGE manages some risk exposure through risk management policies and the use of derivative instruments. MGE's risk management policy prohibits speculative trading transactions.

#### **Commodity Price Risk**

MGE has commodity price risk exposure with respect to the price of natural gas, electricity, coal, emission credits, and oil. MGE employs established policies and procedures to reduce the market risks associated with changing commodity prices. MGE's commodity risks are somewhat mitigated by the current ratemaking process in place for recovering electric fuel cost, purchased energy costs, and the cost of natural gas. MGE's electric fuel costs are subject to fuel rules established by the PSCW.

MGE's electric operations burn natural gas in several of its peaking power plants and, in many cases, the cost of purchased power is tied to the cost of natural gas. MGE bears regulatory risk for the recovery of such fuel and purchased power costs when they are higher than the base rate established in its current rate structure.

The fuel rules require the PSCW and Wisconsin utilities to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band. Any over/under recovery of the actual costs is determined on an annual basis and will be adjusted in future billings to electric retail customers. Under the electric fuel rules, MGE is required to defer the benefit of lower costs if the actual electric fuel rules costs fall outside the lower end of the range and would defer costs, less any excess revenues, if the actual electric fuel rules costs exceeded the upper end of the range. Excess revenues are defined as revenues in the year in question that provide MGE with a greater return on common equity than authorized by the PSCW in MGE's latest rate order. The range is defined by the PSCW and has been modified throughout the years based on market conditions and other relevant factors. Currently, MGE is subject to a plus or minus 2% range. MGE assumes the risks and benefits of variances that are within the cost tolerance band. For 2013, fuel and purchased power costs included in MGE's base fuel rates are \$106.1 million. See Footnote 10.b. for additional information.

MGE recovers the cost of natural gas in its gas segment through the purchased gas adjustment clause (PGA). Under the PGA, MGE is able to pass through to its gas customers the cost of gas.

MGE also reduces price risk caused by market fluctuations via physical contracts and financial derivative contracts, including futures, swaps, options, forwards, and other contractual commitments. The maximum length of time over which cash flows related to energy commodities can be hedged under applicable PSCW approvals is four years.

MGE has financial gas and electric commodity contracts to hedge commodity price risk in the gas and electric segments. These contracts are primarily comprised of exchange-traded option and future contracts. MGE also holds FTRs, which are used to hedge the risk of increased transmission congestion charges. At March 31, 2013, the fair value of these instruments exceeded their cost basis by \$1.5 million. Under the PGA clause and electric fuel rules, MGE may include in the costs of fuel (natural gas or power) the costs and benefits of the aforementioned fuel price risk management tools. Because these costs/benefits are recoverable, the related unrealized loss/gain has been deferred on the consolidated balance sheet as a regulatory asset/liability.

MGE has also entered into a ten-year purchased power agreement that provides MGE with firm capacity and energy that began on June 1, 2012, and ends on May 31, 2022 (the "base term"). The agreement also allows MGE the option to extend the contract after the base term. The agreement is a derivative contract and is recognized at its fair value on the consolidated balance sheet. However, the derivative qualifies for regulatory deferral and is recognized with a corresponding regulatory asset or liability depending on whether the fair value is in a loss or gain position. The fair value of the contract at March 31, 2013, reflects a loss position of \$70.7 million.

## **Interest Rate Risk**

Both MGE Energy and MGE may have short term borrowings at varying interest rates. MGE issues commercial paper for its short-term borrowings, while MGE Energy draws from its current credit facility to meet its short-term borrowing needs. Borrowing levels vary from period to period depending upon capital investments and other factors. Future short-term interest expense and payments will reflect both future short-term interest rates and borrowing levels. MGE Energy and MGE manage interest rate risk by limiting their variable rate exposure and continually monitoring the effects of market changes on interest rates. MGE is not exposed to changes in interest rates on a substantial portion of its long-term debt until that debt matures and is refinanced at market rates.

## **Equity Price Risk - Pension-Related Assets**

MGE currently funds its liabilities related to employee benefits through trust funds. These funds, which include investments in debt and equity securities, are managed by various investment managers. Changes in market value of these investments can have an impact on the future expenses related to these liabilities.

## **Credit Risk - Counterparty**

Credit risk is the loss that may result from counterparty nonperformance. MGE is exposed to credit risk primarily through its merchant energy business. MGE uses credit policies to manage its credit risk, which include utilizing an established credit approval process, monitoring counterparty limits, employing credit mitigation measures such as collateral or prepayment arrangements, and using netting agreements.

Due to the possibility of extreme volatility in the prices of energy commodities and derivatives, the market value of contractual positions with individual counterparties could exceed established credit limits or collateral provided by those counterparties. If such a counterparty were then to fail to perform its obligations under its contract (for example, fail to deliver the electricity MGE originally contracted for), MGE could sustain a loss that could have a material impact on its financial results.

Additionally, if a counterparty were to default and MGE were to liquidate all contracts with that entity, MGE's credit loss would include the loss in value of mark-to-market contracts; the amount owed for settled transactions; and additional payments, if any, to settle unrealized losses on accrual contracts. As of March 31, 2013, no counterparties have defaulted.

MGE is obligated to provide service to all electric and gas customers within its respective franchised territories. MGE's franchised electric territory includes a 316 square-mile area in Dane County, Wisconsin, and MGE's franchised gas territory includes a service area covering 1,631 square miles in Wisconsin. Based on results for the year ended December 31, 2012, no one customer constituted more than 10% of total operating revenues for MGE Energy and MGE. Credit risk for electric and gas is managed by MGE's credit and collection policies, which are consistent with state regulatory requirements.

Cash, cash equivalents, and customer accounts receivable are the financial instruments that potentially subject MGE Energy and MGE to concentrations of credit risk. MGE Energy and MGE place their cash and cash equivalents with high credit-quality financial institutions. MGE has limited concentrations of credit risk from customer accounts receivable because of the large number of customers and relatively strong economy in its service territory.

**Item 4. Controls and Procedures.**

During the first quarter of 2013, each registrant's management, including the principal executive officer and principal financial officer, evaluated its disclosure controls and procedures related to the recording, processing, summarization, and reporting of information in its periodic reports that it files with the SEC. These disclosure controls and procedures have been designed to ensure that material information relating to that registrant, including its subsidiaries, is accumulated and made known to that registrant's management, including these officers, by other employees of that registrant and its subsidiaries as appropriate to allow timely decisions regarding required disclosure, and that this information is recorded, processed, summarized, evaluated, and reported, as applicable, within the time periods specified in the SEC's rules and forms. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision making can be faulty and breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Also, the registrants do not control or manage certain of their unconsolidated entities and thus, their access and ability to apply their procedures to those entities is more limited than is the case for their consolidated subsidiaries.

As of March 31, 2013, each registrant's principal executive officer and principal financial officer concluded that its disclosure controls and procedures were effective. Each registrant intends to strive continually to improve its disclosure controls and procedures to enhance the quality of its financial reporting.

During the quarter ended March 31, 2013, there were no changes in either registrant's internal controls over financial reporting that materially affected, or are reasonably likely to affect materially, that registrant's internal control over financial reporting.



**PART II. OTHER INFORMATION.****Item 1. Legal Proceedings.***MGE Energy and MGE*

MGE Energy and its subsidiaries, including MGE, from time to time are involved in various legal proceedings that are handled and defended in the ordinary course of business.

See Footnote 8.a. and 8.c. for more information.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.****Issuer Purchases of Equity Securities**

Period	Total		Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	Maximum number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs*
	Number of Shares Purchased	Average Price Paid per Share		
January 1-31, 2013	22,070	\$ 52.03	-	-
February 1-28, 2013	22,995	53.14	-	-
March 1-31, 2013	55,875	55.02	-	-
Total	100,940	\$ 53.94	-	-

\* Under the Stock Plan, common stock shares deliverable to plan participants may be either newly issued shares or shares purchased on the open market, as determined from time to time by MGE Energy. In June 2009, MGE Energy switched to using open market purchases to provide shares to meet obligations to participants in the Stock Plan. The

shares are purchased on the open market through a securities broker-dealer and then are reissued under the Stock Plan as needed to meet share delivery requirements. The volume and timing of share repurchases in the open market depends upon the level of dividend reinvestment and optional share purchases being made from time to time by plan participants. As a result, there is no specified maximum number of shares to be repurchased and no specified termination date for the repurchases. All shares issued through the Stock Plan, whether newly issued or reissued following open market purchases, are issued and sold pursuant to a registration statement that was filed with the SEC and is currently effective.

**Item 4. Mine Safety Disclosures.**

Not applicable to MGE Energy and MGE.

**Item 6. Exhibits.**

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Statement regarding computation of ratio of earnings to fixed charges for Madison Gas and Electric Company.

Certifications Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities and Exchange Act of 1934 as to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, filed by the following officers for the following companies:

31.1

Filed by Gary J. Wolter for MGE Energy, Inc.

31.2

Filed by Jeffrey C. Newman for MGE Energy, Inc.

31.3

Filed by Gary J. Wolter for Madison Gas and Electric Company

31.4

Filed by Jeffrey C. Newman for Madison Gas and Electric Company



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Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 United States Code (Sarbanes-Oxley Act of 2002) as to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, filed by the following officers for the following companies:

32.1

Filed by Gary J. Wolter for MGE Energy, Inc.

32.2

Filed by Jeffrey C. Newman for MGE Energy, Inc.

32.3

Filed by Gary J. Wolter for Madison Gas and Electric Company

32.4

Filed by Jeffrey C. Newman for Madison Gas and Electric Company

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Interactive Data Files:

101.INS

XBRL Instance

101.SCH

XBRL Taxonomy Extension Schema

101.CAL

XBRL Taxonomy Extension Calculation

101.DEF

XBRL Taxonomy Extension Definition

101.LAB

XBRL Taxonomy Extension Labels

101.PRE

XBRL Taxonomy Extension Presentation

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**Signatures - MGE Energy, Inc.**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

MGE ENERGY, INC.

Date: May 3, 2013

/s/ Gary J. Wolter  
Gary J. Wolter

Chairman, President and Chief Executive Officer

(Duly Authorized Officer)

Date: May 3, 2013

/s/ Jeffrey C. Newman  
Jeffrey C. Newman

Vice President, Chief Financial Officer, Secretary and  
Treasurer

(Chief Financial and Accounting Officer)

**Signatures - Madison Gas and Electric Company**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

MADISON GAS AND ELECTRIC COMPANY

Date: May 3, 2013

/s/ Gary J. Wolter  
Gary J. Wolter

Chairman, President and Chief Executive Officer

(Duly Authorized Officer)

Date: May 3, 2013

/s/ Jeffrey C. Newman  
Jeffrey C. Newman

Vice President, Chief Financial Officer, Secretary and  
Treasurer

(Chief Financial and Accounting Officer)