

MINNESOTA ENERGY RESOURCES CORPORATION

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017**

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TABLE OF CONTENTS

	<u>Page</u>
FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	
A. Independent Auditors' Report	1
B. Income Statements	2
C. Balance Sheets	3
D. Statements of Cash Flows	4
E. Statements of Equity	5
F. Statements of Capitalization	6
G. Notes to Financial Statements	7
	<u>Page</u>
Note 1 Summary of Significant Accounting Policies	7
Note 2 Acquisition	11
Note 3 Related Parties	11
Note 4 Regulatory Assets and Liabilities	12
Note 5 Property, Plant, and Equipment	13
Note 6 Short-Term Debt to Parent	13
Note 7 Long-Term Debt	13
Note 8 Income Taxes	14
Note 9 Fair Value Measurements	16
Note 10 Derivative Instruments	16
Note 11 Employee Benefits	17
Note 12 Commitments and Contingencies	21
Note 13 Supplemental Cash Flow Information	22
Note 14 Regulatory Environment	22
Note 15 New Accounting Pronouncements	23

GLOSSARY OF TERMS AND ABBREVIATIONS

The abbreviations and terms set forth below are used throughout this report and have the meanings assigned to them below:

Subsidiaries and Affiliates

Integrus	Integrus Holding, Inc. (previously known as Integrus Energy Group, Inc.)
WBS	WEC Business Services LLC
WEC Energy Group	WEC Energy Group, Inc. (previously known as Wisconsin Energy Corporation)
WPS	Wisconsin Public Service Corporation

Federal and State Regulatory Agencies

EPA	United States Environmental Protection Agency
FERC	Federal Energy Regulatory Commission
MPUC	Minnesota Public Utilities Commission

Accounting Terms

ASU	Accounting Standards Update
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
OPEB	Other Postretirement Employee Benefits

Environmental Terms

CO ₂	Carbon Dioxide
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Measurements

Dth	Dekatherm
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Other Terms and Abbreviations

AIA	Affiliated Interest Agreement
ROE	Return on Equity
Tax Legislation	Tax Cuts and Jobs Act of 2017

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

A. INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of Minnesota Energy Resources Corporation:

Milwaukee, Wisconsin

We have audited the accompanying financial statements of Minnesota Energy Resources Corporation (the "Company"), which comprise the balance sheets and statements of capitalization as of December 31, 2017 and 2016, and the related statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Minnesota Energy Resources Corporation as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in accordance with accounting principles generally accepted in the United States of America.

/s/ DELOITTE & TOUCHE LLP

Milwaukee, Wisconsin
March 30, 2018

MINNESOTA ENERGY RESOURCES CORPORATION

B. INCOME STATEMENTS

Year Ended December 31 (in millions)	2017	2016	2015
Operating revenues	\$ 272.0	\$ 248.6	\$ 262.7
Operating expenses			
Cost of sales	151.6	128.5	155.5
Other operation and maintenance	64.9	72.1	64.5
Depreciation and amortization	13.1	11.4	10.5
Property and revenue taxes	10.9	9.0	8.3
Total operating expenses	240.5	221.0	238.8
Operating income	31.5	27.6	23.9
Other expense	—	0.1	—
Interest expense	4.6	4.8	5.9
Other expense	(4.6)	(4.9)	(5.9)
Income before income taxes	26.9	22.7	18.0
Income tax (benefit) expense	(0.5)	9.7	7.3
Net income	\$ 27.4	\$ 13.0	\$ 10.7

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

MINNESOTA ENERGY RESOURCES CORPORATION

C. BALANCE SHEETS

At December 31		
(in millions, except share amounts)		
	2017	2016
Assets		
Current assets		
Cash and cash equivalents	\$ 1.0	\$ 0.9
Accounts receivable and unbilled revenues, net of reserves of \$2.5 and \$2.2, respectively	41.6	41.4
Accounts receivable from related parties	0.1	—
Materials, supplies, and inventories		
Natural gas in storage	10.0	10.2
Materials and supplies	0.2	0.2
Amounts recoverable from customers	21.5	12.8
Prepaid taxes	2.4	7.5
Other	3.0	3.5
Current assets	79.8	76.5
Long-term assets		
Property, plant, and equipment, net of accumulated depreciation of \$153.4 and \$151.1, respectively	378.0	334.0
Regulatory assets	36.6	39.4
Goodwill	127.7	127.7
Other	8.9	2.2
Long-term assets	551.2	503.3
Total assets	\$ 631.0	\$ 579.8
Liabilities and Equity		
Current liabilities		
Short-term debt to parent	\$ 41.7	\$ 36.4
Accounts payable	42.8	25.7
Accounts payable to related parties	3.0	4.4
Accrued taxes	10.5	9.1
Customer credit balances	8.8	10.8
Other	8.6	6.2
Current liabilities	115.4	92.6
Long-term liabilities		
Long-term debt	119.2	—
Long-term debt to parent	—	78.0
Deferred income taxes	74.6	103.4
Regulatory liabilities	80.5	41.1
Other	17.4	18.2
Long-term liabilities	291.7	240.7
Commitments and contingencies (Note 12)		
Common stock – without par value, 100 shares authorized; 100 shares issued and outstanding		
	121.4	171.4
Retained earnings	102.5	75.1
Total common shareholder's equity	223.9	246.5
Total liabilities and equity	\$ 631.0	\$ 579.8

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

MINNESOTA ENERGY RESOURCES CORPORATION

D. STATEMENTS OF CASH FLOWS

Year Ended December 31 (in millions)	2017	2016	2015
Operating activities			
Net income	\$ 27.4	\$ 13.0	\$ 10.7
Reconciliation to cash provided by operating activities			
Depreciation and amortization	13.1	11.4	10.5
Deferred income taxes, net	9.8	18.0	17.0
Contributions and payments related to pension and OPEB plans	(0.1)	—	(0.5)
Change in –			
Accounts receivable and unbilled revenues	(0.3)	(6.7)	30.2
Materials, supplies, and inventories	0.2	4.8	4.2
Amounts recoverable from customers	(8.7)	(4.0)	2.1
Other current assets	4.0	(5.4)	(8.1)
Accounts payable	12.5	2.4	(10.3)
Other current liabilities	1.4	(3.3)	9.3
Other, net	(4.2)	2.8	(5.3)
Net cash provided by operating activities	55.1	33.0	59.8
Investing activities			
Capital expenditures	(48.5)	(34.3)	(30.9)
Purchase of natural gas distribution business	—	—	(9.7)
Payments for assets transferred from WBS	(3.0)	(9.6)	—
Net cash used in investing activities	(51.5)	(43.9)	(40.6)
Financing activities			
Short-term debt to parent, net	5.3	9.8	15.6
Repayment of long-term debt to parent	(78.0)	(29.0)	—
Issuance of long-term debt	120.0	—	—
Return of capital to parent	(50.0)	—	(35.5)
Equity contribution from parent	—	31.0	—
Other, net	(0.8)	—	—
Net cash (used in) provided by financing activities	(3.5)	11.8	(19.9)
Net change in cash and cash equivalents	0.1	0.9	(0.7)
Cash and cash equivalents at beginning of year	0.9	—	0.7
Cash and cash equivalents at end of year	\$ 1.0	\$ 0.9	\$ —

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

MINNESOTA ENERGY RESOURCES CORPORATION

E. STATEMENTS OF EQUITY

<i>(in millions)</i>	Common Stock	Retained Earnings	Total Common Shareholder's Equity
Balance at December 31, 2014	\$ 175.8	\$ 51.4	\$ 227.2
Net income	—	10.7	10.7
Return of capital to parent	(35.5)	—	(35.5)
Other	0.1	—	0.1
Balance at December 31, 2015	\$ 140.4	\$ 62.1	\$ 202.5
Net income	—	13.0	13.0
Equity contribution from parent	31.0	—	31.0
Balance at December 31, 2016	\$ 171.4	\$ 75.1	\$ 246.5
Net income	—	27.4	27.4
Return of capital to parent	(50.0)	—	(50.0)
Balance at December 31, 2017	\$ 121.4	\$ 102.5	\$ 223.9

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

MINNESOTA ENERGY RESOURCES CORPORATION

F. STATEMENTS OF CAPITALIZATION

At December 31				
(in millions)			2017	2016
Common shareholder's equity (see accompanying statement)			\$ 223.9	\$ 246.5
Long-term debt to parent	Interest Rate	Year Due		
Senior Notes	6.40%	2021	—	29.0
	3.99%	2023	—	29.0
	3.57%	2024	—	20.0
Total long-term debt to parent			—	78.0
Long-term debt	Interest Rate	Year Due		
Senior Notes (unsecured)	3.11%	2027	40.0	—
	3.41%	2032	40.0	—
	4.01%	2047	40.0	—
Total			120.0	—
Unamortized debt issuance costs			(0.8)	—
Total long-term debt			119.2	—
Total long-term capitalization			\$ 343.1	\$ 324.5

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

MINNESOTA ENERGY RESOURCES CORPORATION

G. NOTES TO FINANCIAL STATEMENTS

December 31, 2017

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Operations—We are a wholly-owned subsidiary of Integrys. On June 29, 2015, Wisconsin Energy Corporation acquired Integrys, and Integrys became a wholly-owned subsidiary of Wisconsin Energy Corporation. Wisconsin Energy Corporation then changed its name to WEC Energy Group, Inc. In this report, when we refer to the "WEC Merger," we are referring to this acquisition. The WEC Merger was subject to the approvals of various government agencies, including the MPUC. Approvals were obtained from all agencies subject to several conditions. We do not believe the conditions set forth in the various regulatory orders approving the WEC Merger will have a material impact on our operations or financial results.

As used in these notes, the term "financial statements" includes the income statements, balance sheets, statements of cash flows, statements of equity, and statements of capitalization, unless otherwise noted. In this report, when we refer to "us," "we," "our," or "ours," we are referring to Minnesota Energy Resources Corporation.

We are primarily a natural gas utility company that distributes, sells, and transports natural gas to customers in Minnesota. We also have non-utility operations related to servicing appliances for customers. We are subject to the jurisdiction of, and regulation by, the MPUC, which has general supervisory and regulatory powers over public utilities in Minnesota. We are also subject to the standards of conduct and affiliate rules of the FERC.

(b) Basis of Presentation—We prepare our financial statements in conformity with GAAP. We make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

(c) Cash and Cash Equivalents—Cash and cash equivalents include marketable debt securities with an original maturity of three months or less.

(d) Revenues and Customer Receivables—We recognize revenues on the accrual basis and include estimated amounts for services provided but not yet billed to customers.

We present revenues net of pass-through taxes on the income statements.

Below is a summary of the significant mechanisms we had in place that allowed us to recover or refund changes in prudently incurred costs from rate case-approved amounts:

- Our rates included a one-for-one recovery mechanism for natural gas commodity costs. We defer any difference between actual natural gas costs incurred and costs recovered through rates as a current asset or liability. The deferred balance is returned to or recovered from customers at intervals throughout the year.
- Our rates included a conservation improvement program rider for cost recovery of energy conservation and management program costs as well as a financial incentive for meeting energy savings goals.
- Our rates included a decoupling mechanism, which allows us to recover or refund differences between actual and authorized margins. See Note 14, Regulatory Environment, for more information.

We primarily provide regulated natural gas service to customers in Minnesota. Revenues related to our non-utility appliance servicing business were \$15.2 million, \$14.9 million, and \$14.1 million in 2017, 2016, and 2015, respectively. The geographic concentration of our customers did not contribute significantly to our overall exposure to credit risk. We periodically review customers' credit ratings, financial statements, and historical payment performance and require them to provide collateral or other security as needed. As a result, we did not have any significant concentrations of credit risk at December 31, 2017. In addition, there were no customers that accounted for more than 10% of our revenues for the year ended December 31, 2017.

(e) Materials, Supplies, and Inventories—We record substantially all materials, supplies, and natural gas in storage inventories using the weighted-average cost method of accounting.

(f) Regulatory Assets and Liabilities—The economic effects of regulation can result in regulated companies recording costs and revenues that have been or are expected to be allowed in the rate-making process in a period different from the period in which the costs or revenues would be recognized by a nonregulated company. When this occurs, regulatory assets and regulatory liabilities are recorded on the balance sheet. Regulatory assets represent probable future revenues associated with certain costs or liabilities that have been deferred and are expected to be recovered through rates charged to customers. Regulatory liabilities represent amounts that are expected to be refunded to customers in future rates or amounts that are collected in rates for future costs.

Recovery or refund of regulatory assets and liabilities is based on specific periods determined by the regulators or occurs over the normal operating period of the assets and liabilities to which they relate. If at any reporting date a previously recorded regulatory asset is no longer probable of recovery, the regulatory asset is reduced to the amount considered probable of recovery with the reduction charged to expense in the reporting period the determination is made. See Note 4, Regulatory Assets and Liabilities, for more information.

(g) Property, Plant, and Equipment—We record property, plant, and equipment at cost. Cost includes material, labor, overhead, and capitalized interest. Additions to and significant replacements of property are charged to property, plant, and equipment at cost; minor items are charged to other operation and maintenance expense. The cost of depreciable utility property less salvage value is charged to accumulated depreciation when property is retired.

We record straight-line depreciation expense over the estimated useful life of utility property using depreciation rates as approved by the MPUC. Our annual utility composite depreciation rates were 2.51%, 2.53%, and 2.50% for 2017, 2016, and 2015, respectively.

We capitalize certain costs related to software developed or obtained for internal use and record these costs to amortization expense over the estimated useful life of the related software, which ranges from 3 to 15 years. If software is retired prior to being fully amortized, the difference is recorded as a loss on the income statement.

Third parties reimburse us for all or a portion of expenditures for certain capital projects. Such contributions in aid of construction costs are recorded as a reduction to property, plant, and equipment.

See Note 5, Property, Plant, and Equipment, for more information.

(h) Goodwill—Goodwill represents the excess of the cost of an acquisition over the fair value of the identifiable net assets acquired. At December 31, 2017 and 2016, we had gross goodwill of \$144.3 million and accumulated goodwill impairment losses of \$16.6 million, resulting in a net goodwill balance of \$127.7 million.

Goodwill is subject to an annual impairment test. Interim impairment tests are also performed when impairment indicators are present. The carrying amount of a reporting unit's goodwill is considered not recoverable if the carrying amount of the reporting unit exceeds the reporting unit's fair value. We assess fair value by considering future discounted cash flows, public company trading multiples, and merger and acquisition transaction multiples for similar companies. This evaluation utilizes the information available under the circumstances, including reasonable and supportable assumptions and projections. An impairment loss is recorded for the excess of the carrying amount of goodwill over its implied fair value. If an impairment loss exists, it is reflected within operating expenses on the income statements. We completed our annual goodwill impairment test as of July 1, 2017, and no impairment resulted from this test.

(i) Stock-Based Compensation—Prior to the WEC Merger, our employees were granted awards under Integry's stock-based compensation plans. Pursuant to the Agreement and Plan of Merger, dated as of June 22, 2014, between Integry's Energy Group, Inc. and Wisconsin Energy Corporation, immediately prior to completion of the merger, all of Integry's outstanding stock-based compensation awards became fully vested and were either paid to award recipients in cash, or the value of the awards was deferred into a deferred compensation plan. We recorded stock-based compensation expense of \$0.5 million during 2015 under the Integry's plans. The total intrinsic value of awards granted to our employees that were settled in 2015 due to the WEC Merger was \$1.1 million.

In 2016, our employees began participating in WEC Energy Group's stock-based compensation plans. In accordance with the WEC Energy Group shareholder approved WEC Energy Group 1993 Omnibus Stock Incentive Plan, Amended and Restated Effective as of January 1, 2016, WEC Energy Group provides long-term incentives through its equity interests to its non-employee directors, officers, and other key employees. The plan provides for the granting of stock options, restricted stock, performance shares, and other stock-based awards. Awards may be paid in WEC Energy Group common stock, cash, or a combination thereof. Stock-based compensation expense related to these awards is allocated to us based on the outstanding awards held by our employees and our allocation of labor costs. For the years ended December 31, 2017 and 2016, we recorded stock-based compensation expense of \$0.7 million and \$0.5 million, respectively, under the WEC Energy Group plans.

Stock-based compensation costs capitalized during 2017, 2016, and 2015 were not significant.

(j) Common Equity—We do not have any restrictions imposed on us that affect our ability to pay dividends to the sole holder of our common stock, Integrys. We are prohibited from loaning funds to WEC Energy Group, Integrys, or their other subsidiaries.

(k) Income Taxes—We follow the liability method in accounting for income taxes. Accounting guidance for income taxes requires the recording of deferred assets and liabilities to recognize the expected future tax consequences of events that have been reflected in our financial statements or tax returns and the adjustment of deferred tax balances to reflect tax rate changes. We are required to assess the likelihood that our deferred tax assets would expire before being realized. If we conclude that certain deferred tax assets are likely to expire before being realized, a valuation allowance would be established against those assets. GAAP requires that, if we conclude in a future period that it is more likely than not that some or all of the deferred tax assets would be realized before expiration, we reverse the related valuation allowance in that period. Any change to the allowance, as a result of a change in judgment about the realization of deferred tax assets, is reported in income tax expense.

We are included in WEC Energy Group's consolidated Federal and state income tax returns. In accordance with our tax allocation agreement with WEC Energy Group, we are allocated income tax payments and refunds based upon our separate tax computation. See Note 8, Income Taxes, for more information.

We recognize interest and penalties accrued related to unrecognized tax benefits in income tax expense in our income statements.

(l) Fair Value Measurements—Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

Fair value accounting rules provide a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy are defined as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are observable, either directly or indirectly, but are not quoted prices included within Level 1. Level 2 includes those financial instruments that are valued using external inputs within models or other valuation methods.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methods that result in management's best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs.

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. We use a mid-market pricing convention (the mid-point price between bid and ask prices) as a practical measure for valuing certain derivative assets and liabilities. We primarily use a market approach for recurring fair value measurements and attempt to use valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

When possible, we base the valuations of our derivative assets and liabilities on quoted prices for identical assets and liabilities in active markets. These valuations are classified in Level 1. The valuations of certain contracts not classified as Level 1 may be based on quoted market prices received from counterparties and/or observable inputs for similar instruments. Transactions valued using these inputs are classified in Level 2. Certain derivatives are categorized in Level 3 due to the significance of unobservable or internally-developed inputs.

We recognize transfers between the levels of the fair value hierarchy as of the end of the reporting period.

Due to the short-term nature of cash and cash equivalents, net accounts receivable and unbilled revenues, accounts payable, and short-term borrowings, the carrying amount for each such item approximates fair value. The fair value of our long-term debt is estimated based on the quoted market prices of United States Treasury issues having a similar term to maturity, adjusted for our bond rating and the present value of future cash flows. The fair value of long-term debt is categorized within Level 2 of the fair value hierarchy.

See Note 9, Fair Value Measurements, for more information.

(m) Derivative Instruments—We use derivatives as part of our risk management program to manage the risks associated with the price volatility of natural gas costs for the benefit of our customers. Our approach is non-speculative and designed to mitigate risk. Our regulated hedging programs are approved by the MPUC.

We record derivative instruments on our balance sheets as an asset or liability measured at fair value unless they qualify for the normal purchases and sales exception, and are so designated. We continually assess our contracts designated as normal and will discontinue the treatment of these contracts as normal if the required criteria are no longer met. Changes in the derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met or we receive regulatory treatment for the derivative. For most of our natural gas-related physical and financial contracts that qualify as derivatives, the MPUC allows the effects of fair value accounting to be offset to regulatory assets and liabilities.

We classify derivative assets and liabilities as current or long-term on our balance sheets based on the maturities of the underlying contracts. Realized gains and losses on derivative instruments are primarily recorded in cost of sales on the income statements. Cash flows from derivative activities are presented in the same category as the item being hedged within operating activities on our statements of cash flows.

Derivative accounting rules provide the option to present certain asset and liability derivative positions net on the balance sheets and to net the related cash collateral against these net derivative positions. We elected not to net these items. On our balance sheets, cash collateral provided to others is reflected in other current assets. See Note 10, Derivative Instruments, for more information.

(n) Employee Benefits—The costs of pension and OPEB plans are expensed over the periods during which employees render service. These costs are distributed among WEC Energy Group's subsidiaries based on current employment status and actuarial calculations, as applicable. The MPUC allows recovery in rates for the net periodic benefit cost calculated under GAAP. See Note 11, Employee Benefits, for more information.

(o) Customer Deposits and Credit Balances—When customers apply for new service, they may be required to provide a deposit for the service. We use a credit scoring system as one of the methods to determine whether a deposit is necessary. Customer deposits are recorded within other current liabilities on the balance sheets.

Customers can elect to be on a budget plan. Under this type of plan, a monthly installment amount is calculated based on estimated annual usage. During the year, the monthly installment amount is reviewed by comparing it to actual usage. If necessary, an adjustment is made to the monthly amount. Annually, the budget plan is reconciled to actual annual usage. Payments in excess of actual customer usage are presented as customer credit balances on the balance sheets.

(p) Environmental Remediation Costs—We are subject to federal and state environmental laws and regulations that in the future may require us to pay for environmental remediation at sites where we have been, or may be, identified as a potentially responsible party. Loss contingencies may exist for the remediation of hazardous substances at various potential sites, including manufactured gas plant sites. See Note 12, Commitments and Contingencies, for more information.

We record environmental remediation liabilities when site assessments indicate remediation is probable and we can reasonably estimate the loss or a range of losses. The estimate includes both our share of the liability and any additional amounts that will not be paid by other potentially responsible parties or the government. When possible, we estimate costs using site-specific information but also consider historical experience for costs incurred at similar sites. Remediation efforts for a particular site generally extend over a period of several years. During this period, the laws governing the remediation process may change, as well as site conditions, potentially affecting the cost of remediation.

We have received approval to defer certain environmental remediation costs, as well as estimated future costs, through a regulatory asset. The recovery of deferred costs is subject to MPUC approval.

We review our estimated costs of remediation annually for our manufactured gas plant site. We adjust the liability and related regulatory asset, as appropriate, to reflect the new cost estimates. Any material changes in cost estimates are adjusted throughout the year.

(q) Subsequent Events—Subsequent events were evaluated for potential recognition or disclosure through March 30, 2018, which is the date the financial statements were available to be issued.

NOTE 2—ACQUISITION

Purchase of Alliant Energy Corporation's Natural Gas Distribution Business in Southeast Minnesota

On April 30, 2015, we acquired Alliant Energy Corporation's natural gas distribution business in southeast Minnesota for \$12.3 million. The purchase price included a cash payment of \$9.7 million and the issuance of a promissory note to Alliant Energy Corporation for \$2.6 million. The acquisition added about 10,600 new customers into our service area.

NOTE 3—RELATED PARTIES

We routinely enter into transactions with related parties, including WEC Energy Group and its other subsidiaries.

We provide and receive services, property, and other items of value to and from our ultimate parent, WEC Energy Group, and other subsidiaries of WEC Energy Group. Following the WEC Merger on June 29, 2015, Integrys Business Support, LLC (IBS) changed its name to WBS, and a new AIA (Non-WBS AIA) went into effect. The Non-WBS AIA included WEC Energy Group and the former Wisconsin Energy Corporation subsidiaries. It governed the provision and receipt of services by WEC Energy Group's subsidiaries, except that WBS continued to provide services to Integrys and its subsidiaries only under the existing WBS AIAs. WBS provided services to WEC Energy Group and the former Wisconsin Energy Corporation subsidiaries under interim WBS AIAs. The Non-WBS AIA included no other significant changes from the prior Non-IBS AIA. The MPUC and all other relevant state commissions approved the Non-WBS AIA or granted appropriate waivers related to the Non-WBS AIA.

Services under the Non-WBS AIA were subject to various pricing methodologies. All services provided by any regulated subsidiary to another regulated subsidiary were priced at cost. All services provided by any regulated subsidiary to any nonregulated subsidiary were priced at the greater of cost or fair market value. All services provided by any nonregulated subsidiary to any regulated subsidiary were priced at the lesser of cost or fair market value. All services provided by any regulated or nonregulated subsidiary to WBS were priced at cost.

WBS provided several categories of services (including financial, human resource, and administrative services) to us pursuant to the WBS AIAs, which were approved, or from which we were granted appropriate waivers, by the appropriate regulators, including the MPUC. As required by FERC regulations for centralized service companies, WBS renders services at cost. The MPUC must be notified prior to making changes to the services offered under and the allocation methods specified in the WBS AIAs. Other modifications or amendments to the WBS AIAs would require MPUC approval. Recovery of allocated costs is addressed in our rate cases.

A new AIA took effect January 1, 2017. The new agreement replaced the previous agreements. The pricing methodology and services under this new agreement are substantially identical to those under the agreements that were replaced.

The following table shows activity associated with related party transactions:

<i>(in millions)</i>	2017	2016	2015
Billings from WBS *	\$ 26.0	\$ 22.4	\$ 20.6
Interest expense on debt to parent	2.2	4.6	5.7

* Includes \$3.0 million of cash paid related to pension trust assets transferred to us in conjunction with the Integrys pension plan split for the year ended December 31, 2017. Effective January 1, 2017, the Integrys Energy Group Retirement Plan was split into six separate plans. While the split did not impact our pension benefit obligation, federal regulations required a different allocation of assets among the new plans. Assets were transferred into our plan in January 2017. Includes \$3.0 million and \$9.6 million for the transfer of certain software assets to us for the years ended December 31, 2017 and 2016, respectively. Also includes amounts billed for services, pass through costs, and other items in accordance with the approved AIAs discussed above.

See Note 6—Short-Term Debt To Parent, Note 7—Long-Term Debt, and Note 11—Employee Benefits for additional disclosures on related party transactions.

NOTE 4—REGULATORY ASSETS AND LIABILITIES

We recorded a \$38 million change in our deferred taxes due to the enactment of the Tax Legislation, which resulted in an increase to the 2017 Tax Legislation impact and income tax related regulatory liabilities in the table below. The \$38 million change in our deferred taxes represents our estimate of the tax benefit that will be returned to ratepayers through future refunds, bill credits, or reductions in other regulatory assets. See Note 8, Income Taxes, for more information on the Tax Legislation.

The following regulatory assets were reflected on our balance sheets as of December 31:

<i>(in millions)</i>	2017	2016	See Note
Regulatory assets ^{(1) (2)}			
Unrecognized pension and OPEB costs ⁽³⁾	\$ 20.3	\$ 21.8	11
Natural gas costs recoverable through rate adjustments ⁽⁴⁾	19.7	9.6	1(d)
Environmental remediation costs ⁽⁵⁾	9.4	9.0	12
Decoupling	4.4	6.2	14
Energy efficiency programs ⁽⁶⁾	1.8	2.6	
Other	2.5	3.0	
Total regulatory assets	\$ 58.1	\$ 52.2	
Balance Sheet Presentation			
Amounts recoverable from customers	\$ 21.5	\$ 12.8	
Regulatory assets	36.6	39.4	
Total regulatory assets	\$ 58.1	\$ 52.2	

⁽¹⁾ Based on prior and current rate treatment, we believe it is probable that we will continue to recover from customers the regulatory assets in the table.

⁽²⁾ As of December 31, 2017, we had \$35.3 million of regulatory assets not earning a return and \$1.8 million of regulatory assets earning a return based on short-term interest rates. The regulatory assets not earning a return primarily relate to certain unrecognized pension and OPEB costs and certain environmental remediation costs, the recovery of which depends on the timing of the actual expenditure. The other regulatory assets in the table either earn a return or the cash has not yet been expended, in which case the regulatory assets are offset by liabilities.

⁽³⁾ Represents the unrecognized future pension and OPEB costs resulting from actuarial gains and losses on defined benefit and OPEB plans. We are authorized recovery of this regulatory asset over the average remaining service life of each plan.

⁽⁴⁾ Represents natural gas costs that will be recovered from customers in the future.

⁽⁵⁾ As of December 31, 2017, we had not yet made cash expenditures for \$7.4 million of these environmental remediation costs.

⁽⁶⁾ Represents amounts recoverable from customers related to a program designed to meet energy efficiency standards.

The following regulatory liabilities were reflected on our balance sheets as of December 31:

<i>(in millions)</i>	2017	2016	See Note
Regulatory liabilities			
Removal costs *	\$ 41.4	\$ 38.5	
2017 Tax Legislation impact and income tax related	38.5	0.1	8
Other	1.2	2.7	
Total regulatory liabilities	\$ 81.1	\$ 41.3	
Balance Sheet Presentation			
Other current liabilities	\$ 0.6	\$ 0.2	
Regulatory liabilities	80.5	41.1	
Total regulatory liabilities	\$ 81.1	\$ 41.3	

* Represents amounts collected from customers to cover the cost of future removal of property, plant, and equipment.

NOTE 5—PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consisted of the following utility assets at December 31:

<i>(in millions)</i>	2017	2016
Total utility plant	\$ 524.0	\$ 480.8
Less: Accumulated depreciation	153.4	151.1
Net	370.6	329.7
Construction work in progress	7.4	4.3
Total property, plant, and equipment	\$ 378.0	\$ 334.0

NOTE 6—SHORT-TERM DEBT TO PARENT

The following table shows our short-term borrowings and their corresponding weighted-average interest rates as of December 31:

<i>(in millions, except for percentages)</i>	2017	2016
Short-term debt to parent:		
Amount outstanding at December 31	\$ 41.7	\$ 36.4
Weighted-average interest rate on amounts outstanding at December 31	1.63%	0.99%

Our average amount of short-term borrowings based on daily outstanding balances during 2017, was \$26.3 million with a weighted-average interest rate during the period of 1.38%.

<i>(in millions)</i>	December 31, 2017
Revolving short-term notes payable to parent	\$ 50.0
Less:	
Short-term debt to parent outstanding	41.7
Available capacity under existing agreement	\$ 8.3

Our short-term borrowing capacity with Integrys is \$50.0 million. Short-term borrowings bear interest computed at the average stated interest rate payable on commercial paper issued by WEC Energy Group. Short-term debt is callable by Integrys at any time.

NOTE 7—LONG-TERM DEBT

See our statements of capitalization for details on our long-term debt.

In June 2017, we issued \$120.0 million of senior notes. The senior notes were issued in three tranches: \$40.0 million of 3.11% Senior Notes due July 15, 2027; \$40.0 million of 3.41% Senior Notes due July 15, 2032; and \$40.0 million of 4.01% Senior Notes due July 15, 2047. Net proceeds were used to repay our \$78.0 million aggregate long-term debt obligation to our parent, Integrys. Remaining proceeds were used for general corporate purposes, including repayment of short-term debt borrowed from Integrys.

A schedule of all principal debt payment amounts related to our senior note maturities is as follows:

<i>(in millions)</i>	Payments
2018	\$ —
2019	—
2020	—
2021	—
2022	—
Thereafter	120.0
Total	\$ 120.0

NOTE 8—INCOME TAXES

Income Tax Expense

The following table is a summary of income tax expense for each of the years ended December 31:

<i>(in millions)</i>	2017	2016	2015
Current tax benefit	\$ (10.3)	\$ (8.3)	\$ (9.7)
Deferred income taxes, net	9.8	18.0	17.0
Total income tax (benefit) expense	\$ (0.5)	\$ 9.7	\$ 7.3

Statutory Rate Reconciliation

The provision for income taxes for each of the years ended December 31 differs from the amount of income tax determined by applying the applicable United States statutory federal income tax rate to income before income taxes as a result of the following:

<i>(in millions)</i>	2017		2016		2015	
	Amount	Effective Tax Rate	Amount	Effective Tax Rate	Amount	Effective Tax Rate
Expected tax at statutory federal tax rates	\$ 9.4	35.0 %	\$ 7.9	35.0%	\$ 6.4	35.0%
State income taxes net of federal tax benefit	3.0	11.2 %	1.5	6.6%	0.9	5.6%
Federal tax reform	(12.8)	(47.6)%	—	—%	—	—%
Other, net	(0.1)	(0.5)%	0.3	1.1%	—	—%
Total income tax (benefit) expense	\$ (0.5)	(1.9)%	\$ 9.7	42.7%	\$ 7.3	40.6%

The net impact of Tax Legislation in the amount of \$11.6 million is represented in both the federal tax reform and state income taxes net of federal tax benefit lines above.

Deferred Income Tax Assets and Liabilities

On December 22, 2017, the Tax Legislation was signed into law. For businesses, the Tax Legislation reduces the corporate federal tax rate from a maximum of 35% to a 21% rate effective January 1, 2018. We estimated a preliminary net tax benefit related to the re-measurement of our deferred taxes in the amount of approximately \$50 million. Accordingly, a \$38 million tax benefit related to our regulated operations was recorded as an increase to regulatory liabilities as of December 31, 2017. The remeasurement of certain deferred tax liabilities related to our non-utility operations resulted in an income tax benefit of approximately \$11.6 million for the year ended December 31, 2017. Our revaluation of our deferred tax assets and liabilities is subject to further clarification of the new law that cannot be estimated at this time. The impact of the Tax Legislation could materially differ from this estimate due to, among other things, changes in interpretations and assumptions we have made.

On December 22, 2017, the Securities and Exchange Commission staff issued guidance in Staff Accounting Bulletin 118 (SAB 118), Income Tax Accounting Implications of the Tax Cuts and Jobs Act, which provides for a measurement period of up to one year from the enactment date to complete accounting under GAAP for the tax effects of the legislation. Due to the complex and comprehensive nature of the enacted tax law changes, and their application under GAAP, certain amounts related to bonus depreciation and future tax benefit utilization recorded in the financial statements as a result of the Tax Legislation are to be considered "provisional" as discussed in SAB 118 and subject to revision. We are awaiting additional guidance from industry and income tax authorities in order to finalize our accounting.

The components of deferred income taxes as of December 31 were as follows:

<i>(in millions)</i>	2017	2016
Deferred tax assets		
Tax gross up - regulatory items	\$ 11.1	\$ —
Other	3.5	10.8
Total deferred tax assets	\$ 14.6	\$ 10.8
Deferred tax liabilities		
Property-related	\$ 75.7	\$ 95.5
Regulatory deferrals	8.8	10.3
Employee benefits and compensation	4.5	5.6
Other	0.2	2.8
Total deferred tax liabilities	89.2	114.2
Deferred tax liability, net	\$ 74.6	\$ 103.4

Consistent with rate-making treatment, deferred taxes in the table above are offset for temporary differences that have related regulatory assets and liabilities.

At December 31, 2017, we had \$0.1 million of federal tax credit carryforwards resulting in deferred tax assets of \$0.1 million. These tax credit carryforwards begin to expire in 2033. At December 31, 2016, we had \$9.0 million, \$0.1 million, and \$0.2 million of federal net operating loss, tax credit, and charitable contribution carryforwards resulting in deferred tax assets of \$3.2 million, \$0.1 million, and \$0.1 million, respectively.

At December 31, 2017, we had no significant state deferred tax assets related to tax credit carryforwards. At December 31, 2016, we had \$5.6 million of state net operating loss carryforwards, resulting in deferred tax assets of \$0.4 million.

Valuation allowances have not been established for deferred income tax assets based on our projected ability to realize these benefits by off-setting future taxable income.

Unrecognized Tax Benefits

We had no unrecognized tax benefits at December 31, 2017 and 2016.

We do not expect any unrecognized tax benefits to affect our effective tax rate in periods after December 31, 2017.

For the years ended December 31, 2017, 2016, and 2015, we recognized no accrued interest or penalties related to unrecognized tax benefits in our income statements. We also had no accrued interest or penalties related to unrecognized tax benefits on our balance sheets at December 31, 2017 and 2016.

We do not anticipate any significant increases or decreases in the total amounts of unrecognized tax benefits within the next 12 months.

Our primary tax jurisdictions include federal and the state of Minnesota. With a few exceptions, we are no longer subject to federal income tax examinations by the United States Internal Revenue Service for years prior to 2014. At December 31, 2017, we were subject to examination by the Minnesota taxing authority for tax years 2014 through 2017.

NOTE 9—FAIR VALUE MEASUREMENTS

The following tables summarize our financial assets and liabilities that were accounted for at fair value on a recurring basis, categorized by level within the fair value hierarchy:

(in millions)	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Derivative assets				
Natural gas contracts	\$ 0.1	\$ —	\$ —	\$ 0.1
Derivative liabilities				
Natural gas contracts	0.4	—	—	0.4

(in millions)	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Derivative assets				
Natural gas contracts	\$ 1.2	\$ —	\$ —	\$ 1.2

The derivative assets and liabilities listed in the tables above include options and futures used to manage volatility in natural gas supply costs. See Note 10, Derivative Instruments, for more information.

Fair Value of Financial Instruments

The following table shows the financial instruments included on our balance sheets that are not recorded at fair value at December 31:

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	\$ 119.2	\$ 118.9	\$ —	\$ —
Long-term debt to parent	—	—	78.0	84.3

NOTE 10—DERIVATIVE INSTRUMENTS

The following table shows our derivative assets and derivative liabilities:

(in millions)	December 31, 2017		December 31, 2016	
	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
Other current				
Natural gas contracts	\$ 0.1	\$ 0.4	\$ 1.2	\$ —

Our estimated notional sales volumes and realized losses were as follows for the years ended:

(in millions)	December 31, 2017		December 31, 2016		December 31, 2015	
	Volume	Losses	Volume	Losses	Volume	Losses
Natural gas contracts	6.9 Dth	\$ (1.2)	9.1 Dth	\$ (4.1)	9.4 Dth	\$ (4.6)

At December 31, 2017 and 2016, we had posted cash collateral of \$0.9 million and \$0.2 million, respectively.

The following table shows derivative assets and derivative liabilities if derivative instruments by counterparty were presented net on our balance sheets:

(in millions)	December 31, 2017		December 31, 2016	
	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
Gross amount recognized on the balance sheet	\$ 0.1	\$ 0.4	\$ 1.2	\$ —
Gross amount not offset on the balance sheet	(0.1)	(0.4) *	—	—
Net amount	\$ —	\$ —	\$ 1.2	\$ —

* Includes cash collateral posted of \$0.3 million.

NOTE 11—EMPLOYEE BENEFITS

Pension and Other Postretirement Employee Benefits

Through December 31, 2016, we participated in the Integrys Energy Group retirement plan, a noncontributory, qualified pension plan sponsored by WBS. We were responsible for our share of the plan assets and obligations. Effective January 1, 2017, the Integrys Energy Group Retirement Plan was split into six separate plans. As a result, we now have our own pension plan. While the split did not impact our pension benefit obligation, federal regulations required a different allocation of assets among the new plans. Assets were transferred into our plan in January 2017. During 2017, we paid \$3.0 million related to pension trust assets transferred to us in conjunction with the Integrys pension plan split. We also participate in an unfunded, non-qualified retirement plan sponsored by WPS. In addition, we maintain an unfunded, non-qualified Supplemental Employee Retirement Plan.

We offer OPEB plans to employees, which are sponsored by WPS. We are responsible for our share of the plan assets and obligations for all these plans. Our balance sheets reflect only the liabilities associated with our past and current employees and our share of the plan assets. WEC Energy Group also offers medical, dental, and life insurance benefits to our active employees and their dependents. We expense the allocated costs of these benefits as incurred.

The defined benefit pension plan is closed to all new hires. In addition, the service accruals for the defined benefit pension plan were frozen for non-union employees as of January 1, 2013. These employees receive an annual company contribution to their 401(k) savings plan, which is calculated based on age, wages, and full years of vesting service as of December 31 each year. In October 2017, we remeasured the obligations of our OPEB plan as a result of a plan design change to move all participants to the same Medicare Advantage plan design starting January 1, 2018.

We use a year-end measurement date to measure the funded status of all of our pension and OPEB plans. Due to the regulated nature of our business, we have concluded that substantially all of the unrecognized costs resulting from the recognition of the funded status of our pension and OPEB plans qualify as a regulatory asset.

The following table shows information relating to the plans' benefit obligations and fair value of assets.

As of December 31: (in millions)	Pension Costs		OPEB Costs	
	2017	2016	2017	2016
Benefit obligation	\$ 46.1	\$ 43.6	\$ 6.6	\$ 6.1
Fair value of plan assets	51.1	43.5	3.3	3.7
Funded status	\$ 5.0	\$ (0.1)	\$ (3.3)	\$ (2.4)
For the years ended December 31:				
Employer contributions	\$ —	\$ —	\$ 0.1	\$ —
Participant contributions	—	—	0.2	0.7
Benefit payments	(2.6)	(3.5)	(1.0)	(1.3)

The amounts recognized on our balance sheets at December 31 related to the funded status of the benefit plans were as follows:

<i>(in millions)</i>	Pension Costs		OPEB Costs	
	2017	2016	2017	2016
Other long-term assets	\$ 5.1	\$ —	\$ —	\$ —
Other long-term liabilities	0.1	0.1	3.3	2.4
Total net assets (liabilities)	\$ 5.0	\$ (0.1)	\$ (3.3)	\$ (2.4)

The accumulated benefit obligation for the qualified pension plans was \$46.0 million and \$42.9 million at December 31, 2017 and 2016, respectively.

The following table shows information for pension plans with an accumulated benefit obligation in excess of plan assets. There were no plan assets related to these pension plans. Amounts presented are as of December 31:

<i>(in millions)</i>	2017	2016
Projected benefit obligation	\$ 0.2	\$ 0.2
Accumulated benefit obligation	0.2	0.2

The following table shows the amounts that had not yet been recognized in our net periodic benefit cost as of December 31:

<i>(in millions)</i>	Pension Costs		OPEB Costs	
	2017	2016	2017	2016
Net regulatory assets				
Net actuarial loss	\$ 16.2	\$ 18.1	\$ 4.5	\$ 4.1
Prior service credits	—	—	(0.4)	(0.4)
Total	\$ 16.2	\$ 18.1	\$ 4.1	\$ 3.7

The following table shows the estimated amounts that will be amortized into net periodic benefit cost during 2018:

<i>(in millions)</i>	Pension Costs	OPEB Costs
Net actuarial loss	\$ 1.4	\$ 0.3
Total 2018 – estimated amortization	\$ 1.4	\$ 0.3

The amount of net periodic benefit cost recognized (including amounts capitalized to our balance sheets) for the years ended December 31 was as follows:

<i>(in millions)</i>	Pension Costs			OPEB Costs		
	2017	2016	2015	2017	2016	2015
Net periodic benefit cost (credit)	\$ (0.2)	\$ 0.3	\$ 0.8	\$ 0.5	\$ 0.5	\$ 0.3

The weighted-average assumptions used to determine benefit obligations for the plans were as follows for the years ended December 31:

	Pension		OPEB	
	2017	2016	2017	2016
Discount rate	3.60%	4.20%	3.42%	3.83%
Rate of compensation increase	4.00%	4.00%	N/A	N/A
Assumed medical cost trend rate (Pre 65)	N/A	N/A	6.50%	7.00%
Ultimate trend rate	N/A	N/A	5.00%	5.00%
Year ultimate trend rate is reached	N/A	N/A	2024	2021
Assumed medical cost trend rate (Post 65)	N/A	N/A	6.00%	7.00%
Ultimate trend rate	N/A	N/A	5.00%	5.00%
Year ultimate trend rate is reached	N/A	N/A	2028	2021

The weighted-average assumptions used to determine net periodic benefit cost for the plans were as follows for the years ended December 31:

	Pension Costs		OPEB Costs	
	2017	2016	2017	2016
Discount rate	4.20%	4.26%	3.74%	4.08%
Expected return on assets	7.25%	7.25%	7.25%	7.25%
Rate of compensation increase	4.00%	4.00%	N/A	N/A
Assumed medical cost trend rate (Pre 65/Post 65)	N/A	N/A	7.00%	7.50%
Ultimate trend rate	N/A	N/A	5.00%	5.00%
Year ultimate trend rate is reached	N/A	N/A	2021	2021

WEC Energy Group consults with its investment advisors on an annual basis to help forecast expected long-term returns on plan assets by reviewing historical returns as well as calculating expected total trust returns using the weighted-average of long-term market returns for each of the major target asset categories utilized in the fund. For 2018, the expected return on assets assumption for the pension and OPEB plans is 7.25%.

Plan Assets

Current pension trust assets and amounts which are expected to be contributed to the trusts in the future are expected to be adequate to meet pension payment obligations to current and future retirees.

The Investment Trust Policy Committee oversees investment matters related to all of our funded benefit plans. The Committee works with external actuaries and investment consultants on an on-going basis to establish and monitor investment strategies and target asset allocations. Forecasted cash flows for plan liabilities are regularly updated based on annual valuation results. Target allocations are determined using projected benefit payments and risk analyses of appropriate investments. They are intended to reduce risk, provide long-term financial stability for the plans and maintain funded levels which meet long-term plan obligations while preserving sufficient liquidity for near-term benefit payments.

Our pension plan's assets are invested in a corporate pension trust with a target asset allocation of 45% equity investments, 45% fixed income investments, and 10% private equity and real estate investments. Our two largest OPEB trusts have target asset allocations of 45% equity investments and 55% fixed income, and 50% equity investments and 50% fixed income, respectively. Equity securities include investments in large-cap, mid-cap, and small-cap companies. Fixed income securities include corporate bonds of companies from diversified industries, mortgage and other asset backed securities, commercial paper, and United States Treasuries.

Pension and OPEB plan investments are recorded at fair value. See Note 1(I), Fair Value Measurements, for more information regarding the fair value hierarchy and the classification of fair value measurements based on the types of inputs used.

The following tables provide the fair values of our investments by asset class:

(in millions)	December 31, 2017							
	Pension Plan Assets				OPEB Plan Assets			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Asset class								
Cash and cash equivalents	\$ —	\$ 1.6	\$ —	\$ 1.6	\$ —	\$ 0.1	\$ —	\$ 0.1
Equity securities:								
United States Equity	7.0	—	—	7.0	0.5	—	—	0.5
International Equity	7.1	—	—	7.1	0.5	—	—	0.5
Fixed income securities: *								
United States Bonds	1.3	9.2	—	10.5	0.2	0.6	—	0.8
International Bonds	0.2	1.5	—	1.7	—	0.1	—	0.1
Private Equity and Real Estate	—	4.5	0.9	5.4	—	0.2	—	0.2
	15.6	16.8	0.9	33.3	1.2	1.0	—	2.2
Investments measured at net asset value				17.8				1.1
Total	\$ 15.6	\$ 16.8	\$ 0.9	\$ 51.1	\$ 1.2	\$ 1.0	\$ —	\$ 3.3

* This category represents investment grade bonds of United States and foreign issuers denominated in United States dollars from diverse industries.

(in millions)	December 31, 2016							
	Pension Plan Assets				OPEB Plan Assets			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Asset class								
Cash and cash equivalents	\$ 0.1	\$ 1.1	\$ —	\$ 1.2	\$ 0.1	\$ 0.1	\$ —	\$ 0.2
Equity securities:								
United States Equity	5.6	—	—	5.6	0.3	—	—	0.3
International Equity	1.1	—	—	1.1	0.1	—	—	0.1
Fixed income securities: *								
United States Bonds	—	9.0	—	9.0	—	0.6	—	0.6
International Bonds	—	1.2	—	1.2	—	0.1	—	0.1
	6.8	11.3	—	18.1	0.5	0.8	—	1.3
Investments measured at net asset value				25.4				2.4
Total	\$ 6.8	\$ 11.3	\$ —	\$ 43.5	\$ 0.5	\$ 0.8	\$ —	\$ 3.7

* This category represents investment grade bonds of United States and foreign issuers denominated in United States dollars from diverse industries.

The following table sets forth a reconciliation of changes in the fair value of pension and OPEB plan assets categorized as Level 3 in the fair value hierarchy during 2017. There was no level 3 activity in 2016.

(in millions)	Private Equity and Real Estate
	Pension
Beginning balance at January 1, 2017	\$ —
Purchases	0.9
Ending balance at December 31, 2017	\$ 0.9

Cash Flows

We expect to make \$0.1 million in contributions to our OPEB plans in 2018. We do not expect to make any contributions to our pension plans in 2018. Contributions to our pension and OPEB plans are dependent on various factors affecting us, including our liquidity position and the effects of the new Tax Legislation.

The following table shows the payments, reflecting expected future service, that we expect to make for pension and OPEB:

<i>(in millions)</i>	Pension	OPEB
2018	\$ 4.0	\$ 0.8
2019	3.4	0.7
2020	3.4	0.6
2021	2.8	0.6
2022	2.5	0.6
2023 through 2027	13.3	2.8

Savings Plans

WEC Energy Group sponsors a 401(k) savings plan which allows our employees to contribute a portion of their pre-tax and/or after-tax income in accordance with plan-specified guidelines. A percentage of employee contributions are matched by us through a contribution into the employee's savings plan account, up to certain limits. Certain employees participate in a defined contribution pension plan, in which amounts are contributed to an employee's savings plan account based on the employee's wages, age, and years of service. Our share of the total costs incurred under all of these plans was \$1.8 million in 2017 and \$1.7 million in both 2016 and 2015.

NOTE 12—COMMITMENTS AND CONTINGENCIES

We have significant commitments and contingencies arising from our operations, including those related to unconditional purchase obligations, environmental matters, and enforcement and litigation matters.

Unconditional Purchase Obligations

We have obligations to distribute and sell natural gas to our customers and expect to recover costs related to these obligations in future customer rates. In order to meet these obligations, we routinely enter into long-term purchase and sale commitments for various quantities and lengths of time.

The following table shows our minimum future commitments related to these purchase obligations as of December 31, 2017.

<i>(in millions)</i>	Date Contracts Extend Through	Total Amounts Committed	Payments Due By Period					Later Years
			2018	2019	2020	2021	2022	
Natural gas supply and transportation	2043	\$ 582.7	\$ 46.6	\$ 51.6	\$ 55.9	\$ 41.2	\$ 34.7	\$ 352.7

Environmental Matters

Consistent with other companies in the natural gas utility industry, we face significant ongoing environmental compliance and remediation obligations related to current and past operations. Specific environmental issues affecting us include, but are not limited to, current and future regulation of greenhouse gas emissions and remediation of impacted properties, including former manufactured gas plant sites.

We have continued to pursue a proactive strategy to manage our environmental compliance obligations, including:

- the protection of wetlands and waterways, threatened and endangered species, and cultural resources associated with utility construction projects;
- the reporting of CO₂ emissions to comply with air quality standards and federal clean air rules; and

- the remediation of former manufactured gas plant sites.

Environmental Protection Agency Greenhouse Gases Reporting Program

We are required to report our CO₂ equivalent emissions related to the natural gas that we distribute and sell under the EPA Greenhouse Gases Reporting Program. For 2016, we reported aggregated CO₂ equivalent emissions of approximately 2.3 million metric tonnes to the EPA. Based upon our preliminary analysis of the data, we estimate that we will report CO₂ equivalent emissions of approximately 2.3 million metric tonnes to the EPA for 2017.

Manufactured Gas Plant Remediation

We have identified a site at which a predecessor company owned or operated a manufactured gas plant or stored manufactured gas. We acquired this site as a result of our purchase of Alliant Energy Corporation's natural gas distribution business in 2015. See Note 2, Acquisition, for more information. We are responsible for the environmental remediation of this site. We are also working with the Minnesota Pollution Control Agency on our investigation, monitoring, and remediation.

The future costs for detailed site investigation, future remediation, and monitoring are dependent upon several variables including, among other things, the extent of remediation, changes in technology, and changes in regulation. Historically, our regulators have allowed us to recover incurred costs, net of insurance recoveries and recoveries from potentially responsible parties, associated with the remediation of manufactured gas plant sites. Accordingly, we have established a regulatory asset for costs associated with this site.

We have established the following regulatory asset and reserve related to our manufactured gas plant site as of December 31:

<i>(in millions)</i>	2017	2016
Regulatory asset	\$ 9.4	\$ 9.0
Reserve for future remediation *	7.4	6.8

* The reserve for future remediation is included in other long-term liabilities on our balance sheets.

Enforcement and Litigation Matters

We are involved in legal and administrative proceedings before various courts and agencies with respect to matters arising in the ordinary course of business. Although we are unable to predict the outcome of these matters, management believes that appropriate reserves have been established and that final settlement of these actions will not have a material effect on our financial condition or results of operations.

NOTE 13—SUPPLEMENTAL CASH FLOW INFORMATION

<i>(in millions)</i>	2017	2016	2015
Cash (paid) for interest, net of amount capitalized	\$ (4.0)	\$ (5.6)	\$ (3.2)
Cash received for income taxes, net	15.1	2.9	6.5
Significant non-cash transactions:			
Accounts payable related to construction costs	7.1	3.7	3.3
Purchase of a natural gas distribution business in Minnesota financed with note payable	—	—	2.6

NOTE 14—REGULATORY ENVIRONMENT

Tax Cuts and Jobs Act of 2017

We deferred for return to ratepayers, through future refunds, bill credits, riders, or reductions in other regulatory assets, the estimated tax benefit of \$38 million related to the Tax Legislation that was signed into law in December 2017. This tax benefit resulted from the revaluation of deferred taxes related to our regulated operations. See Note 8, Income Taxes, for more information.

2018 Rate Case

In October 2017, we initiated a rate proceeding with the MPUC to increase retail natural gas rates \$12.6 million (5.05%). Our request reflects a 10.3% ROE and a common equity component average of 50.9%. The proposed retail natural gas rate increase is primarily driven by increased capital investments as well as general inflation. We are also requesting authority from the MPUC to continue the use of our currently authorized decoupling mechanism.

In November 2017, the MPUC approved an interim rate order, effective January 1, 2018, authorizing a retail natural gas rate increase of \$9.5 million (3.78%). In March 2018, to reflect changes in our effective tax rate as a result of the enactment of the Tax Legislation, the MPUC approved a \$2.5 million reduction in our interim retail natural gas rates to \$7.0 million (2.81%), effective April 1, 2018. The interim rates reflect a 9.11% ROE and a common equity component average of 50.9%. The interim rate increase is subject to refund pending the final written rate order, which is expected in the first half of 2019.

2016 Rate Order

In September 2015, we initiated a rate proceeding with the MPUC. In October 2016, the MPUC issued a final written order, effective March 1, 2017. The order authorized a retail natural gas rate increase of \$6.8 million (3.0%). The rates reflected a 9.11% ROE and a common equity component average of 50.32%. The order approved our request to continue the use of our decoupling mechanism for another three years. The final approved rate increase was lower than the interim rates collected from customers during 2016. Therefore, we refunded \$4.1 million to customers in 2017.

2015 Rate Order

In September 2013, we initiated a rate proceeding with the MPUC. In October 2014, the MPUC issued a final written order, effective April 1, 2015. The order authorized a retail natural gas rate increase of \$7.6 million (2.9%). The rates reflected a 9.35% ROE and a common equity component average of 50.31%. The order approved a deferral of customer billing system costs, for which recovery was requested in our 2016 rate case. The order also approved our request to continue the use of our decoupling mechanism with a 10% cap for our residential and small commercial and industrial customers. The final approved rate increase was lower than the interim rates collected from customers during 2014. Therefore, we refunded \$4.7 million to customers in 2015.

Natural Gas Extension Project

In response to anticipated growth and customer demand, we are expanding our natural gas distribution system in and around the city of Rochester, Minnesota (Rochester Project). The estimated cost of this project is \$44 million, excluding allowance for funds used during construction. In October 2015, we filed an application with the MPUC to recover a portion of the costs of the Rochester Project pursuant to Minnesota's new Natural Gas Extension Project statute through a rider. The rider allows recovery of one-third of the revenue deficiency in excess of the amounts included in base rates in a non-rate case year for eligible natural gas extension projects. In a rate case year, any revenue deficiency for these projects would be collected entirely through base rates. In May 2017, the MPUC issued a final order approving recovery of the cost of the Rochester Project, up to the initial estimate of \$44 million, as well as the future use of the rider. Construction of the Rochester Project began in 2017. We are projecting a revenue deficiency related to the Rochester project in 2019 and, consistent with the commission's May 2017 order, we filed for approval in February 2018 to recover the 2019 revenue deficiency through the implementation of the rider starting January 1, 2019. We expect to receive an order from the MPUC related to the implementation of the rider in late 2018.

NOTE 15—NEW ACCOUNTING PRONOUNCEMENTS

Revenue Recognition

In May 2014, the FASB and the International Accounting Standards Board issued their joint revenue recognition standard, ASU 2014-09, Revenue from Contracts with Customers. Several amendments were issued subsequent to the standard to clarify the guidance. The core principle of the guidance is to recognize revenue in an amount that an entity is entitled to receive in exchange for goods and services. The guidance also requires additional disclosures about the nature, amount, timing, and uncertainty of revenues and the related cash flows arising from contracts with customers.

We have completed the review of our contracts with customers and are finalizing the related financial disclosures to evaluate the impact of the amended guidance on our existing revenue recognition policies and procedures. We have evaluated the nature of our operating revenues and do not expect that there will be a significant shift in the timing or pattern of revenue recognition. Most of our revenues are from regulated tariff sales, which are in the scope of the new standard, excluding the revenue component related to alternative revenue programs. The revenues from these contracts are recorded at the amount of the natural gas delivered to the customer during the period.

We adopted this standard for interim and annual periods beginning January 1, 2018, and used the modified retrospective method of adoption. The most significant impact to the financial statements is expected to be in the form of additional disclosures. However, we do not expect to have a cumulative-effect adjustment to record on the balance sheet as of the beginning of 2018; and therefore, do not expect to include a reconciliation of results under the new revenue recognition guidance compared with what would have been reported in 2018 under the old revenue recognition guidance. We will include disaggregated revenue disclosures by customer class in the notes to financial statements, starting in 2018.

Recognition and Measurement of Financial Instruments

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities. This guidance requires equity investments, including other ownership interests such as partnerships, unincorporated joint ventures, and limited liability companies, to be measured at fair value with changes in fair value recognized in net income. It also simplifies the impairment assessment of equity investments without readily determinable fair values and amends certain disclosure requirements associated with the fair value of financial instruments. This ASU does not apply to investments accounted for under the equity method of accounting. We adopted this ASU for interim and annual periods beginning January 1, 2018. We do not believe the adoption of this guidance will have a significant impact on our financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, Leases. This guidance is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020, and will be applied using a modified retrospective approach. The main provision of this ASU is that lessees will be required to recognize lease assets and lease liabilities for most leases, including those classified as operating leases under GAAP. We are currently assessing the effects this guidance may have on our financial statements.

Financial Instruments Credit Losses

In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments. This guidance is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. This ASU introduces a new impairment model known as the current expected credit loss model. The ASU requires a financial asset measured at amortized cost to be presented at the net amount expected to be collected. Previously, recognition of the full amount of credit losses was generally delayed until the loss was probable of occurring. We are currently assessing the effects this guidance may have on our financial statements.

Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. There are eight main provisions of this ASU for which current GAAP either is unclear or does not include specific guidance. We adopted this ASU for interim and annual periods beginning January 1, 2018, and used a retrospective transition method. We do not believe the adoption of this guidance will have a significant impact on our financial statements.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. Under this ASU, an employer is required to disaggregate the service cost component from the other components of the net benefit cost. The amendments provide explicit guidance on how to present the service cost component and the other components of the net benefit cost in the income statement and allow only the service cost component of the net benefit cost to be eligible for capitalization. We adopted this ASU for interim and annual periods beginning January 1, 2018. The amendments will be applied retrospectively for the presentation of the service cost component and the other components of the net benefit cost in the income statement, and prospectively for the capitalization of the service cost component in assets. As a result of the application of accounting principles for rate regulated entities, a similar amount of net benefit cost (including non-service components) will be recognized in our financial statements consistent with the current rate-making treatment. The impacts of adoption will be limited to changes in classification of non-service costs in the income statements.