**United States**

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

*For the quarterly period ended:*

## September 30, 2012

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

*For the transition period from _______________ to _______________*

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

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 [X] 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 [X] 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.

| | Large Accelerated Filer | Accelerated Filer | Non-accelerated Filer | Smaller Reporting Company |
|---|---|---|---|---|
| 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 [X]

| Number of Shares Outstanding of Each Class of Common Stock as of October 31, 2012 | |
|---|---|
| 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 (a) include those factors discussed in the Registrants' 2011 Annual Report on Form 10-K: Item 1A. Risk Factors, as updated by Part II. Item 1A. Risk Factors in this Report, 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: | |
| 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 |
| cooling degree days | Measure of the extent to which the average daily temperature is above 65 degrees Fahrenheit, which is considered an indicator of possible increased demand for energy to provide cooling |
| CSAPR | Cross-State Air Pollution Rule |
| CWA | Clean Water Act |
| CWDC | Central Wisconsin Development Corporation |
| DOE | U.S. Department of Energy |
| Dth | Dekatherms, a quantity measure used in respect of natural gas |
| Elm Road Units | Elm Road Generating Station |
| EPA | United States Environmental Protection Agency |
| ERISA | Employee Retirement Income Security Act |
| EGU | Electric Generating Unit |
| 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 |
| NO2 | Nitrogen Dioxide |
| NOV | Notice of Violation |
| NOx | 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 |
| 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)*

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| **Operating Revenues:** | | | | |
| Regulated electric revenues | $ 118,914 | $ 114,963 | $ 305,189 | $ 291,804 |
| Regulated gas revenues | 16,587 | 17,249 | 92,235 | 119,748 |
| Nonregulated revenues | 2,337 | 1,360 | 6,894 | 3,884 |
| *Total Operating Revenues* | 137,838 | 133,572 | 404,318 | 415,436 |
| **Operating Expenses:** | | | | |
| Fuel for electric generation | 16,395 | 16,656 | 36,727 | 39,304 |
| Purchased power | 18,102 | 18,024 | 54,962 | 49,997 |
| Cost of gas sold | 7,389 | 8,171 | 50,035 | 72,170 |
| Other operations and maintenance | 41,975 | 39,744 | 126,202 | 119,814 |
| Depreciation and amortization | 9,706 | 10,296 | 29,042 | 30,669 |
| Other general taxes | 4,383 | 4,347 | 13,937 | 13,053 |
| *Total Operating Expenses* | 97,950 | 97,238 | 310,905 | 325,007 |
| **Operating Income** | 39,888 | 36,334 | 93,413 | 90,429 |
| Other income, net | 2,856 | 2,341 | 7,975 | 6,880 |
| Interest expense, net | (4,849) | (5,142) | (14,717) | (15,047) |
| Income before income taxes | 37,895 | 33,533 | 86,671 | 82,262 |
| Income tax provision | (14,253) | (12,495) | (32,711) | (30,718) |
| **Net Income** | $ 23,642 | $ 21,038 | $ 53,960 | $ 51,544 |
| **Earnings Per Share of Common Stock** (basic and diluted) | $ 1.02 | $ 0.91 | $ 2.33 | $ 2.23 |
| Dividends per share of common stock | $ 0.395 | $ 0.383 | $ 1.161 | $ 1.133 |
| **Average Shares Outstanding** (basic and diluted) | 23,114 | 23,114 | 23,114 | 23,114 |

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Net Income | $ 23,642 | $ 21,038 | $ 53,960 | $ 51,544 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized gain (loss) on available-for-sale securities, net of tax ($5 and $50, and $24 and $4) | (8) | (74) | 35 | 7 |
| Reclassification of realized gain on available-for-sale securities, net of tax ($- and $-, and $- and $10) | - | - | - | (15) |
| **Comprehensive Income** | $ 23,634 | $ 20,964 | $ 53,995 | $ 51,536 |

*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)*

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2012** | **2011** |
| **Operating Activities:** | | |
| Net income | $ 53,960 | $ 51,544 |
| Items not affecting cash: | | |
| Depreciation and amortization | 29,042 | 30,669 |
| Deferred income taxes | 54,602 | 16,854 |
| Provision for doubtful receivables | 1,537 | 1,441 |
| Employee benefit plan expenses | 13,815 | 10,259 |
| Equity earnings in ATC | (6,764) | (6,434) |
| Other items | 1,632 | 1,044 |
| Changes in working capital items: | | |
| (Increase) decrease in current assets | (9,002) | 27,868 |
| Decrease in current liabilities | (13,418) | (10,547) |
| Dividend income from ATC | 5,300 | 5,012 |
| Cash contributions to pension and other postretirement plans | (24,336) | (22,484) |
| Other noncurrent items, net | 9,518 | 1,299 |
| *Cash Provided by Operating Activities* | 115,886 | 106,525 |
| **Investing Activities:** | | |
| Capital expenditures | (65,909) | (44,859) |
| Capital contributions to investments | (1,988) | (958) |
| Purchase of investment - land | (2) | (2,152) |
| Other | (289) | 80 |
| *Cash Used for Investing Activities* | (68,188) | (47,889) |
| **Financing Activities:** | | |
| Cash dividends paid on common stock | (26,820) | (26,183) |
| Repayment of long-term debt | (30,000) | (1,834) |
| Issuance of long-term debt | 28,000 | 30,000 |
| Decrease in short-term debt | - | (22,500) |
| Other | (844) | (336) |
| *Cash Used for Financing Activities* | (29,664) | (20,853) |
| **Change in Cash and Cash Equivalents:** | 18,034 | 37,783 |
| Cash and cash equivalents at beginning of period | 41,169 | 7,110 |
| Cash and cash equivalents at end of period | $ 59,203 | $ 44,893 |
| **Supplemental disclosures of cash flow information:** | | |
| Significant noncash investing activities: | | |
| Accrued capital expenditures | $ 7,649 | $ 2,606 |

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

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

| ASSETS | September 30, 2012 | December 31, 2011 |
|---|---|---|
| **Current Assets:** | | |
| Cash and cash equivalents | $ 59,203 | $ 41,169 |
| Receivable - margin account | 1,653 | 2,477 |
| Accounts receivable, less reserves of $3,516 and $3,662, respectively | 33,315 | 36,744 |
| Other accounts receivable, less reserves of $611 and $439, respectively | 4,621 | 5,318 |
| Unbilled revenues | 19,095 | 25,754 |
| Materials and supplies, at average cost | 17,014 | 14,758 |
| Fossil fuel | 6,863 | 5,468 |
| Stored natural gas, at average cost | 17,218 | 19,575 |
| Prepaid taxes | 43,590 | 22,251 |
| Regulatory assets - current | 8,350 | 7,347 |
| Other current assets | 8,885 | 8,270 |
| *Total Current Assets* | 219,807 | 189,131 |
| Regulatory assets | 230,418 | 205,835 |
| Other deferred assets and other | 7,298 | 8,018 |
| **Property, Plant, and Equipment:** | | |
| Property, plant, and equipment, net | 967,556 | 961,511 |
| Construction work in progress | 75,748 | 34,055 |
| *Total Property, Plant, and Equipment* | 1,043,304 | 995,566 |
| Investments | 63,829 | 60,332 |
| **Total Assets** | $ 1,564,656 | $ 1,458,882 |
| | | |
| **LIABILITIES AND CAPITALIZATION** | | |
| **Current Liabilities:** | | |
| Long-term debt due within one year | $ 2,667 | $ 2,667 |
| Accounts payable | 29,238 | 34,532 |
| Accrued interest and taxes | 4,064 | 4,085 |
| Accrued payroll related items | 9,409 | 9,987 |
| Deferred income taxes | 1,577 | 3,020 |
| Derivative liabilities | 9,600 | 4,568 |
| Other current liabilities | 3,421 | 4,215 |
| *Total Current Liabilities* | 59,976 | 63,074 |
| **Other Credits:** | | |
| Deferred income taxes | 256,689 | 199,850 |
| Investment tax credit - deferred | 1,585 | 1,780 |
| Regulatory liabilities | 25,817 | 20,463 |
| Accrued pension and other postretirement benefits | 166,788 | 183,622 |
| Derivative liabilities | 67,490 | 34,908 |
| Other deferred liabilities and other | 48,685 | 43,330 |
| *Total Other Credits* | 567,054 | 483,953 |
| **Capitalization:** | | |
| Common shareholders' equity | 578,127 | 550,952 |
| Long-term debt | 359,499 | 360,903 |
| *Total Capitalization* | 937,626 | 911,855 |
| Commitments and contingencies (see Footnote 8) | - | - |
| **Total Liabilities and Capitalization** | $ 1,564,656 | $ 1,458,882 |

*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 | | Additional Paid-in | Retained | Accumulated Other Comprehensive | |
|---|---|---|---|---|---|---|
| | Shares | Value | Capital | Earnings | (Loss)/Income | Total |
| **2011** | | | | | | |
| Beginning balance - December 31, 2010 .... | 23,114 | $ 23,114 | $ 316,268 | $ 185,556 | $ 142 | $ 525,080 |
| Net income.................................................. | | | | 51,544 | | 51,544 |
| Other comprehensive loss........................... | | | | | (8) | (8) |
| Common stock dividends declared ($1.133 per share)....................................... | | | | (26,183) | | (26,183) |
| Ending balance - September 30, 2011......... | 23,114 | $ 23,114 | $ 316,268 | $ 210,917 | $ 134 | $ 550,433 |
| **2012** | | | | | | |
| Beginning balance - December 31, 2011 .... | 23,114 | $ 23,114 | $ 316,268 | $ 211,458 | $ 112 | $ 550,952 |
| Net income.................................................. | | | | 53,960 | | 53,960 |
| Other comprehensive income...................... | | | | | 35 | 35 |
| Common stock dividends declared ($1.161 per share)....................................... | | | | (26,820) | | (26,820) |
| Ending balance - September 30, 2012......... | 23,114 | $ 23,114 | $ 316,268 | $ 238,598 | $ 147 | $ 578,127 |

*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)*

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| **Operating Revenues:** | | | | |
| Regulated electric revenues | $ 118,914 | $ 114,963 | $ 305,189 | $ 291,804 |
| Regulated gas revenues | 16,587 | 17,249 | 92,235 | 119,748 |
| Nonregulated revenues | 2,337 | 1,360 | 6,894 | 3,884 |
| *Total Operating Revenues* | 137,838 | 133,572 | 404,318 | 415,436 |
| **Operating Expenses:** | | | | |
| Fuel for electric generation | 16,395 | 16,656 | 36,727 | 39,304 |
| Purchased power | 18,102 | 18,024 | 54,962 | 49,997 |
| Cost of gas sold | 7,389 | 8,171 | 50,035 | 72,170 |
| Other operations and maintenance | 41,766 | 39,558 | 125,320 | 119,162 |
| Depreciation and amortization | 9,706 | 10,296 | 29,042 | 30,669 |
| Other general taxes | 4,384 | 4,347 | 13,938 | 13,053 |
| Income tax provision | 13,669 | 11,525 | 30,273 | 28,082 |
| *Total Operating Expenses* | 111,411 | 108,577 | 340,297 | 352,437 |
| **Operating Income** | 26,427 | 24,995 | 64,021 | 62,999 |
| **Other Income and Deductions:** | | | | |
| AFUDC - equity funds | 514 | 101 | 978 | 304 |
| Equity in earnings in ATC | 2,280 | 2,167 | 6,764 | 6,434 |
| Income tax provision | (587) | (933) | (2,555) | (2,689) |
| Other income, net | (77) | (56) | (207) | (217) |
| *Total Other Income and Deductions* | 2,130 | 1,279 | 4,980 | 3,832 |
| Income before interest expense | 28,557 | 26,274 | 69,001 | 66,831 |
| **Interest Expense:** | | | | |
| Interest on long-term debt | 5,065 | 5,214 | 15,335 | 15,428 |
| Other interest, net | 25 | 8 | (116) | (244) |
| AFUDC - borrowed funds | (209) | (40) | (398) | (123) |
| *Net Interest Expense* | 4,881 | 5,182 | 14,821 | 15,061 |
| **Net Income** | $ 23,676 | $ 21,092 | $ 54,180 | $ 51,770 |
| Less Net Income Attributable to Noncontrolling Interest, net of tax | (6,153) | (6,010) | (18,305) | (17,935) |
| **Net Income Attributable to MGE** | $ 17,523 | $ 15,082 | $ 35,875 | $ 33,835 |

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Net Income | $ 23,676 | $ 21,092 | $ 54,180 | $ 51,770 |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized loss on available-for-sale securities, net of tax ($5 and $35, and $20 and $14) | (7) | (52) | (30) | (20) |
| Reclassification of realized gain on available-for-sale securities, net of tax ($- and $-, and $- and $10) | - | - | - | (15) |
| **Comprehensive Income** | $ 23,669 | $ 21,040 | $ 54,150 | $ 51,735 |
| Less: Comprehensive income attributable to Noncontrolling Interest, net of tax | (6,153) | (6,010) | (18,305) | (17,935) |
| **Comprehensive Income attributable to MGE** | $ 17,516 | $ 15,030 | $ 35,845 | $ 33,800 |

*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)*

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2012 | 2011 |
| **Operating Activities:** | | |
| Net income | $ 54,180 | $ 51,770 |
| Items not affecting cash: | | |
| Depreciation and amortization | 29,042 | 30,669 |
| Deferred income taxes | 53,984 | 16,160 |
| Provision for doubtful receivables | 1,537 | 1,441 |
| Employee benefit plan expenses | 13,815 | 10,259 |
| Equity earnings in ATC | (6,764) | (6,434) |
| Other items | 2,028 | 1,468 |
| Changes in working capital items: | | |
| (Increase) decrease in current assets | (10,446) | 26,349 |
| Decrease in current liabilities | (14,052) | (10,407) |
| Dividend income from ATC | 5,300 | 5,012 |
| Cash contributions to pension and other postretirement plans | (24,336) | (22,484) |
| Other noncurrent items, net | 9,281 | 1,238 |
| *Cash Provided by Operating Activities* | 113,569 | 105,041 |
| **Investing Activities:** | | |
| Capital expenditures | (65,909) | (44,859) |
| Capital contributions to investments | (1,775) | (888) |
| Other | (271) | 373 |
| *Cash Used for Investing Activities* | (67,955) | (45,374) |
| **Financing Activities:** | | |
| Cash dividends paid to parent by MGE | (13,456) | (19,921) |
| Distributions to parent from noncontrolling interest | (15,500) | (43,000) |
| Equity contribution received by noncontrolling interest | 1,775 | 888 |
| Repayment of long-term debt | (30,000) | (1,834) |
| Issuance of long-term debt | 28,000 | 30,000 |
| Decrease in short-term debt | - | (3,500) |
| Other | (795) | (297) |
| *Cash Used for Financing Activities* | (29,976) | (37,664) |
| **Change in Cash and Cash Equivalents:** | 15,638 | 22,003 |
| Cash and cash equivalents at beginning of period | 13,898 | 4,494 |
| Cash and cash equivalents at end of period | $ 29,536 | $ 26,497 |
| **Supplemental disclosures of cash flow information:** | | |
| Significant noncash investing activities: | | |
| Accrued capital expenditures | $ 7,649 | $ 2,606 |

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

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

| ASSETS | September 30, 2012 | December 31, 2011 |
|---|---|---|
| **Current Assets:** | | |
| Cash and cash equivalents | $ 29,536 | $ 13,898 |
| Receivable - margin account | 1,653 | 2,477 |
| Accounts receivable, less reserves of $3,516 and $3,662, respectively | 32,621 | 35,765 |
| Affiliate receivables | 572 | 605 |
| Other accounts receivable, less reserves of $611 and $439, respectively | 4,606 | 5,301 |
| Unbilled revenues | 19,095 | 25,754 |
| Materials and supplies, at average cost | 17,014 | 14,758 |
| Fossil fuel | 6,863 | 5,468 |
| Stored natural gas, at average cost | 17,218 | 19,575 |
| Prepaid taxes | 44,515 | 21,977 |
| Regulatory assets - current | 8,350 | 7,347 |
| Other current assets | 8,851 | 8,245 |
| *Total Current Assets* | 190,894 | 161,170 |
| Affiliate receivable long-term | 6,487 | 6,884 |
| Regulatory assets | 230,418 | 205,835 |
| Other deferred assets and other | 6,721 | 7,286 |
| **Property, Plant, and Equipment:** | | |
| Property, plant, and equipment, net | 967,052 | 961,007 |
| Construction work in progress | 75,748 | 34,055 |
| *Total Property, Plant, and Equipment* | 1,042,800 | 995,062 |
| Investments | 60,743 | 57,556 |
| **Total Assets** | $ 1,538,063 | $ 1,433,793 |
| | | |
| **LIABILITIES AND CAPITALIZATION** | | |
| **Current Liabilities:** | | |
| Long-term debt due within one year | $ 2,667 | $ 2,667 |
| Accounts payable | 29,238 | 34,532 |
| Affiliate payables | 1,143 | 2,152 |
| Accrued interest and taxes | 4,017 | 4,037 |
| Accrued payroll related items | 9,409 | 9,987 |
| Deferred income taxes | 1,646 | 3,020 |
| Derivative liabilities | 9,600 | 4,568 |
| Other current liabilities | 3,577 | 3,997 |
| *Total Current Liabilities* | 61,297 | 64,960 |
| **Other Credits:** | | |
| Deferred income taxes | 252,656 | 196,550 |
| Investment tax credit - deferred | 1,585 | 1,780 |
| Regulatory liabilities | 25,817 | 20,463 |
| Accrued pension and other postretirement benefits | 166,788 | 183,622 |
| Derivative liabilities | 67,490 | 34,908 |
| Other deferred liabilities and other | 48,685 | 43,330 |
| *Total Other Credits* | 563,021 | 480,653 |
| **Capitalization:** | | |
| Common shareholder's equity | 435,315 | 412,926 |
| Noncontrolling interest | 118,931 | 114,351 |
| *Total Equity* | 554,246 | 527,277 |
| Long-term debt | 359,499 | 360,903 |
| *Total Capitalization* | 913,745 | 888,180 |
| Commitments and contingencies (see Footnote 8) | - | - |
| **Total Liabilities and Capitalization** | $ 1,538,063 | $ 1,433,793 |

*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 |
|---|---|---|---|---|---|---|---|
| **2011** | | | | | | | |
| Beginning balance - Dec. 31, 2010 | 17,348 | $ 17,348 | $ 192,417 | $ 192,480 | $ 71 | $ 141,993 | $ 544,309 |
| Net income | | | | 33,835 | | 17,935 | 51,770 |
| Other comprehensive loss | | | | | (35) | | (35) |
| Cash dividends paid to parent by MGE | | | | (19,921) | | | (19,921) |
| Equity contribution received by noncontrolling interest | | | | | | 888 | 888 |
| Distributions to parent from noncontrolling interest | | | | | | (43,000) | (43,000) |
| Ending balance - September 30, 2011 | 17,348 | $ 17,348 | $ 192,417 | $ 206,394 | $ 36 | $ 117,816 | $ 534,011 |
| **2012** | | | | | | | |
| Beginning balance - Dec. 31, 2011 | 17,348 | $ 17,348 | $ 192,417 | $ 203,114 | $ 47 | $ 114,351 | $ 527,277 |
| Net income | | | | 35,875 | | 18,305 | 54,180 |
| Other comprehensive loss | | | | | (30) | | (30) |
| Cash dividends paid to parent by MGE | | | | (13,456) | | | (13,456) |
| Equity contribution received by noncontrolling interest | | | | | | 1,775 | 1,775 |
| Distributions to parent from noncontrolling interest | | | | | | (15,500) | (15,500) |
| Ending balance - September 30, 2012 | 17,348 | $ 17,348 | $ 192,417 | $ 225,533 | $ 17 | $ 118,931 | $ 554,246 |

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

## 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.

The accompanying consolidated financial statements as of September 30, 2012, and for the three and nine 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 2011 Annual Report on Form 10-K, but does not include all disclosures required by accounting principles in the United States of America. These notes should be read in conjunction with the financial statements and the notes on pages 54 through 107 of the 2011 Annual Report on Form 10-K.

## 2. Equity and Financing Arrangements.

### a. Common Stock - MGE Energy.

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 nine months ended September 30, 2012 and 2011, MGE Energy did not issue any new shares of common stock under the Stock Plan.

### b. Preferred Stock – MGE Energy and MGE.

As of September 30, 2012, and December 31, 2011, MGE has 1,175,000 shares of $25 par value redeemable preferred stock (cumulative) that is authorized but unissued. On October 25, 2012, MGE amended and restated its existing Restated Articles of Incorporation, which eliminated the previously authorized cumulative preferred stock. There were no shares of cumulative preferred stock issued and outstanding at the date of the amendment.

### c. Dilutive Shares Calculation - MGE Energy.

MGE Energy does not hold any dilutive securities.

### d. Long-term Debt - MGE Energy and MGE.

On April 2, 2012, MGE issued $28 million in principal amount of its 4.38% senior notes, due April 1, 2042. The Notes were issued pursuant to a Note Purchase Agreement. The Notes are unsecured and are not issued under, or governed by, MGE's Indenture dated as of September 1, 1998, which governs MGE's Medium-Term Notes. MGE used the net proceeds from the sale of the Notes, together with other available corporate funds, to repay and retire on April 3, 2012, its obligations under a Loan Agreement dated as of April 1, 2002 with the City of Madison, Wisconsin, under which MGE received the net proceeds from the issuance of $28 million aggregate principal amount of 5.875% Series 2002A, Industrial Development Revenue Bonds that were issued by the City of Madison for MGE's benefit. The 5.875% Series 2002A Bonds were redeemed and retired on April 3, 2012, at 100% of their principal amount plus accrued interest with the proceeds of that loan repayment. Any interest savings in 2012 will be deferred.

**e. Remarketing of 4.875% Series 2002B, Industrial Development Revenue Bonds - MGE Energy and MGE.**

On April 2, 2012, $19.3 million of 4.875% Series 2002B, Industrial Development Revenue Bonds were remarketed at an interest rate of 3.45%. The net proceeds of the 4.875% Series 2002B Bonds were originally loaned to MGE pursuant to a Loan Agreement dated as of April 1, 2002 with the City of Madison, which issued the Series 2002B Bonds in 2002. MGE is responsible for the payment of principal, premium, if any, and interest on the Bonds. The 4.875% Series 2002B Bonds were originally issued bearing an interest rate of 4.875% per annum for a period that ended April 1, 2012, at which point the Bonds were subject to mandatory tender by their holders and remarketing. The Series 2002B Bonds were remarketed and carry an interest rate of 3.45% per annum, which is payable semi-annually on April 1 and October 1, until their maturity on October 1, 2027. The Series 2002B Bonds are redeemable on or after April 1, 2017, at a redemption price equal to 100% of the principal amount of the Bonds to be redeemed, plus accrued interest to the redemption date.

## 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 nine months ended September 30, 2012 and 2011, MGE Transco recorded equity earnings from the investment in ATC of $6.8 million and $6.4 million, respectively. Dividend income received from ATC was $5.3 million and $5.0 million for the nine months ended September 30, 2012 and 2011, respectively. In addition, during the nine months ended September 30, 2012 and 2011, MGE Transco made $1.8 million and $0.9 million in capital contributions to ATC, respectively.

MGE Energy and MGE's investment in ATC as of September 30, 2012, and December 31, 2011, was $60.3 million and $57.0 million, respectively.

At September 30, 2012, 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 and nine months ended September 30, 2012 and 2011, is as follows:

| *(In thousands)* | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Operating revenues | $ 150,303 | $ 142,741 | $ 450,136 | $ 420,562 |
| Operating expenses | (68,813) | (66,413) | (210,139) | (192,491) |
| Other expense, net | (5) | (173) | (832) | (665) |
| Interest expense, net | (20,983) | (19,517) | (61,260) | (60,893) |
| Earnings before members' income taxes | $ 60,502 | $ 56,638 | $ 177,905 | $ 166,513 |

## 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 $SO_2$ and mercury emissions. The scrubbers and bag houses are expected to support compliance obligations for current and anticipated air quality regulations, including CAIR or CSAPR, the Utility MACT Rule and the Wisconsin Mercury Rule. The operator's current estimate shows that MGE's share of the capital expenditures required for this project will be approximately $140 million. As of September 30, 2012, MGE had accumulated $42.3 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 expects to incur capital expenditures as follows: $18 million for the remainder of 2012, $68 million in 2013, and $12 million in 2014. These amounts may change as a result of modifications to the project estimate or timing differences. MGE has recognized $0.7 million (after tax) in AFUDC equity related to this project for the nine months ended September 30, 2012.

MGE expects that the costs pertaining to this project will be fully recoverable through rates. Additionally, MGE is entitled to a carrying cost on the related construction costs at 100% of the determined AFUDC rate.

## 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 in accordance with Treasury Regulations and case law, as compared to the prior method of claiming tax depreciation on project costs. The method change for electric generation and transmission and distribution repairs was included on the 2009 tax return while the change for gas distribution repairs was included on the 2010 return. During 2011, the IRS issued guidance on the treatment of electric transmission and distribution repairs. This guidance prompted the reversal of a portion of the unrecognized tax benefits for these repairs during 2011. MGE Energy and MGE have an unrecognized tax benefit at September 30, 2012, and December 31, 2011, in the amount of $3.2 million and $2.4 million, respectively, for the tax uncertainty primarily related to the change in tax method of accounting for electric generation and gas distribution repairs.

### b. Effective Tax Rate.

MGE Energy's effective income tax rate for the three and nine months ended September 30, 2012, is 37.6% and 37.7%, respectively, compared to 37.3% and 37.3% for the same periods in 2011; and MGE's effective income tax rate for the three and nine months ended September 30, 2012, is 37.6% and 37.7%, respectively, compared to 37.1% and 37.3% for the same periods in 2011.

## 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 and nine months ended September 30, 2012 and 2011. A portion of the net periodic benefit cost is capitalized within the consolidated balance sheets.

| *(In thousands)* | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| **Pension Benefits** | | | | |
| Components of net periodic benefit cost: | | | | |
| Service cost | $ 1,871 | $ 1,527 | $ 5,613 | $ 4,581 |
| Interest cost | 3,236 | 3,055 | 9,711 | 9,165 |
| Expected return on assets | (3,917) | (3,502) | (11,756) | (10,507) |
| Amortization of: | | | | |
| Prior service cost | 111 | 108 | 333 | 324 |
| Actuarial loss | 2,058 | 939 | 6,177 | 2,816 |
| Net periodic benefit cost | $ 3,359 | $ 2,127 | $ 10,078 | $ 6,379 |
| **Postretirement Benefits** | | | | |
| Components of net periodic benefit cost: | | | | |
| Service cost | $ 626 | $ 500 | $ 1,879 | $ 1,501 |
| Interest cost | 1,089 | 1,010 | 3,267 | 3,028 |
| Expected return on assets | (421) | (407) | (1,263) | (1,221) |
| Amortization of: | | | | |
| Transition obligation | 103 | 110 | 309 | 329 |
| Prior service cost | 27 | 28 | 81 | 85 |
| Actuarial loss | 601 | 114 | 1,802 | 342 |
| Net periodic benefit cost | $ 2,025 | $ 1,355 | $ 6,075 | $ 4,064 |

The PSCW allowed MGE to defer the 2009 incremental pension and OPRB costs above the amounts recovered in rates. During the three months ended September 30, 2012 and 2011, $0.3 million and $0.7 million, respectively, has been recovered in rates. During the nine months ended September 30, 2012 and 2011, $0.9 million and $2.0 million, respectively, 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 2008 through 2011, on February 17, 2012, 16,693 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 the award based on the current market value of MGE Energy common stock. The fair value of the awards has been subsequently re-measured at September 30, 2012, 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 April 2011, the MGE Energy Board approved an amendment to the outstanding awards under the Performance Unit Plan to provide for the continued vesting of those awards in the event of a bona fide retirement, provided the retired individual does not provide services to a competitor. The amendment did not change the number of performance units covered by any outstanding awards currently held by any of the participants. As a result of the changes made by the amendment, the Company accelerated the recognition of costs associated with the outstanding awards resulting in a compensation-related charge of $0.5 million in the second quarter of 2011.

During the nine months ended September 30, 2012 and 2011, MGE recorded $1.4 million and $0.9 million, respectively, in compensation expense as a result of the Performance Unit Plan. In January 2012, cash payments of $0.6 million were distributed relating to awards that were granted in 2007 and became payable under the Performance Unit Plan. No forfeitures occurred during the nine months ended September 30, 2012 or 2011. At September 30, 2012, $3.1 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 emissions 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 regulates discharges from "point sources" such as power plants by 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))*
In April 2011, the EPA proposed and asked for public comment on standards to reduce entrainment (drawing aquatic life into a plant's cooling system) and impingement (trapping aquatic life on screens) from existing structures designed to take in cooling water for plants such as power plants. This rule is commonly referred to as Phase II of Section 316(b) of the CWA. Both our Blount and Columbia generating plants are subject to the impingement and entrainment aspects of the current proposed rule. Our WCCF plant is subject to the impingement aspect only. Under the current proposed rule, equipment would need to be installed at Blount, WCCF and Columbia to meet these new standards. The EPA has until June 27, 2013 to issue the final rule, pursuant to a recently announced settlement agreement. It is not presently possible to estimate the potential costs associated with the implementation of any of these initiatives because the rule has not been finalized.

*WPDES Thermal Discharge Rule*
WDNR rules to regulate thermal effluent discharges from point sources in Wisconsin became effective on October 1, 2010. We will need to meet the revised rule requirement as MGE's WPDES permits are issued or renewed. Blount's WPDES permit was renewed effective October 1, 2012, with thermal effluent discharge limits in place. We believe that the thermal limits set are achievable without additional capital expenditures. We will continue to monitor this requirement as our other plant permits come up for renewal. If we, in the case of WCCF, or the plant operator, in the cases of Columbia and Elm Road, are unable to demonstrate that any of these permitted plants are able to comply with its associated WPDES permit requirements, then we may face operational controls and/or incur capital costs associated with plant modifications to meet discharge requirements. Those expenditures could be material, but would be anticipated to be recoverable in rates.

*WPDES Phosphorus Nutrient Standards*
In December 2010, the WDNR established water quality standards for phosphorus and effluent limitations for permitted discharges into specific waterbodies. Phosphorus limitations will be added to water effluent discharge permits, as applicable, as they are issued or renewed. The WDNR will be developing site-specific phosphorus limits. MGE's facilities subject to these standards include Blount, Columbia, Elm Road and WCCF. Blount's WPDES permit was renewed effective October 1, 2012, with phosphorus discharge limits in place. We believe that the phosphorus limits set are achievable without additional capital expenditures. We will continue to monitor this requirement as our other plant permits come up for renewal. MGE may incur additional capital or operational expenditures and/or need to install additional pollution controls to meet any new phosphorus limits. MGE has, however, identified potential compliance options and believes compliance can be managed without significant capital investments.

**Air quality**

Air quality regulations promulgated by the EPA and the WDNR in accordance with the Federal Clean Air Act and the Clean Air Act Amendments of 1990 impose restrictions on emission of particulates, sulfur dioxide ($SO_2$), nitrogen oxides ($NO_x$), 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 the EPA's interstate transport rules, are expected to result in additional operating and capital expenditure costs for electric generating units.

*Maximum Achievable Control Technology (MACT) for Utility Boilers (Also Referred to as the Mercury and Air Toxics Standards or MATS)*
In December 2011, the EPA finalized its Mercury and Air Toxics Standards for coal and oil-burning electric generating Unit (EGU) boilers. MATS will require emissions standards for mercury, non-mercury HAPs metals, and acid gases. 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 are expected to allow both facilities to comply with the MATS rule (see the discussion regarding Columbia below).

*Reciprocating Internal Combustion Engine (RICE) MACT*
In December 2011, the EPA finalized its RICE MACT standard. RICE MACT applies to an industrial or electrical engine that is classified as a reciprocating internal combustion engine. Under the current RICE MACT, MGE may have to adjust its dispatching of several small generation units used for emergency and backup generation or install pollution controls. In June 2012, the EPA introduced a proposed rule that revised RICE MACT and introduced an amendment to the New Source Performance Standard for RICE based on a settlement agreement with several power companies. MGE is currently reviewing the proposed rule and evaluating potential impacts associated with complying with the proposed RICE MACT.

*Vacation of EPA's Cross State Air Pollution Rule (CSAPR) and Reinstatement of the Clean Air Interstate Rule (CAIR)*
EPA has so far promulgated three interstate air pollution rules [the $NO_x$ SIP Call, the Clean Air Interstate Rule (CAIR) and the Cross-State Air Pollution Rule (CSAPR)] which were each designed to reduce nitrogen oxide ($NO_x$) and/or sulphur dioxide ($SO_2$) air emissions from electric generating units (EGUs) located in Wisconsin and other states. $NO_x$ and $SO_2$ interact in the atmosphere to form ambient ozone and fine particulate matter pollution. As explained below, only the CAIR currently affects MGE's generation assets.

In 2000, the U.S. Court of Appeals for the D.C. Circuit held that Wisconsin had been illegally included in a portion of the $NO_x$ SIP Call, but stayed the remaining legal challenges to the rule pending EPA's development of additional interstate transport rules. At this time, the requirements of the $NO_x$ SIP Call and the costs of compliance remain uncertain.

In 2005, EPA promulgated the CAIR imposing additional controls on $NO_x$ and $SO_2$ emissions from EGUs located in Wisconsin and other states. However, 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 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 replacement rule. The EPA has petitioned the U.S. Court of Appeals for the D.C. Circuit to reconsider its decision *en banc*. At this time, the CAIR remains currently effective.

The CAIR, which became effective in 2009 and remains effective currently, generally requires $NO_x$ and $SO_2$ emission reductions from fossil fuel-fired electric generating units (25 MW or greater) (EGUs) 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 $NO_x$ and 40% for $SO_2$. The second phase (beginning in 2015) reduces regional $NO_x$ and $SO_2$ 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, and its combustion turbines located in West Marinette and Fitchburg.

Our evaluation of the CAIR demonstrates that MGE will be in compliance with the CAIR's Phase I requirements without capital expenditures or modifications to our operations. We have also evaluated our potential expenditures if the CAIR remains in place for the Phase II reductions. New $SO_2$ controls at Columbia are already underway and are planned to be completed by mid to late 2014 (see the discussion regarding the Columbia Environmental Project below). Once the new environmental control project is completed at Columbia, it is expected that the plant will emit below anticipated Phase II CAIR allocation levels. MGE expects that any costs incurred to meet Phase II of the CAIR will be fully recoverable through rates.

MGE will continue monitoring the EPA's actions in response to the August 2012 CSAPR vacature and the stayed $NO_x$ SIP Call litigation, but MGE is unable to predict the outcome of these matters and its impact on its operations or financial condition.

*Clean Air Visibility Rule (CAVR)*
Air modeling indicates that $SO_2$ and $NO_x$ emissions (and to a lesser extent particulate matter, or PM) 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 requires pollution retrofits. The EPA had proposed that Columbia's compliance with emissions limitations in the CAIR and the CSAPR could also serve as compliance with the BART regulations for $SO_2$ and $NO_x$ emissions. However, this proposal is now uncertain because of the D.C. Circuit remanding the CAIR to EPA and vacating the CSAPR. At this time the BART regulatory obligations, compliance strategies and costs remain uncertain.

*Wisconsin State Mercury Rule*
Beginning January 1, 2015, phase two of the Wisconsin mercury rule will require large coal-fired electric generating units (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 $NO_x$ and $SO_2$ emissions at prescribed rates. Elm Road currently meets this requirement. The Columbia co-owners expect to meet the 90% reduction option by installing bag houses and scrubbers by mid to late 2014 (see the discussion regarding the Columbia Environmental Project below).

*National Ambient Air Quality Standards (NAAQS)*
The EPA has developed National Ambient Air Quality Standards (NAAQS) for six compounds currently identified as criteria pollutants: nitrogen dioxide ($NO_2$), particulate matter (PM), ozone, $SO_2$, lead and carbon monoxide. The NAAQS for criteria pollutants establish acceptable ambient air levels based on 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. MGE is currently tracking two NAAQS developments: (1) EPA's proposed changes to the PM2.5 NAAQS announced in June 2012, which would lower the primary annual limit and add a secondary PM2.5 standard pertaining to a measure of visibility, and (2) the WDNR attainment/nonattainment designations associated with the EPA's June 2010 final revisions to its $SO_2$ NAAQS. Because of uncertainties in how these NAAQS developments will be implemented in Wisconsin, we are tracking developments and evaluating potential costs at our generation facilities. Based on our current evaluation, these two NAAQS developments have the most potential to affect capital and maintenance costs at our Columbia plant. However, the potential impact at any of our plants will not be known until implementation of the rules is finalized.

*EPA's Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule*
The EPA's Greenhouse Gas "Tailoring Rule" regulates stationary sources for GHG emissions by "phasing in" over time different types of facilities subject to Prevention of Significant Deterioration (PSD) pre-construction program or Title V permitting (i.e. new facilities and existing facilities with certain qualifying modifications). MGE facilities may become subject to this rule in the future if modifications at any facilities trigger PSD or if MGE invests in new facilities that trigger PSD.

*GHG New Source Performance Standards for Electric Generating Units (EGU GHG NSPS)*
On March 27, 2012, the EPA proposed greenhouse gas (GHG) New Source Performance Standards (NSPS) for coal fired and natural gas combined cycle (NGCC) electric generation units (EGUs). The proposal applies to new EGUs only; the EPA has stated that it does not intend for these rules to apply to modified or existing units at this time. The proposed NSPS may yet be finalized in 2012, but is not anticipated to significantly affect MGE's existing generation units.

**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 $SO_2$ 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 and the Wisconsin Mercury Rule. The operator's current estimate shows that MGE's share of the capital expenditures required for this project will be approximately $140 million. The project is underway and estimated to be completed in mid to late 2014.

As of September 30, 2012, various contractual commitments have been entered for the project. MGE's share of these commitments as of September 30, 2012, is $89.1 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. A citizen group petitioned the EPA to object to the issuance of 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. The WDNR took various preliminary actions but has not yet fully responded to the EPA's 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. 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 the Columbia generating station. The NOV alleges that WPL, as operator, and the co-owners 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 has stated it believes the projects at Columbia were routine, or not projected to increase emissions, and therefore did not violate the permitting requirements of the CAA. MGE and the other Columbia co-owners are defending against these allegations while actively pursuing settlement options with the EPA and Sierra Club.

MGE believes that the parties have reached a tentative agreement on the general terms of a settlement with the EPA and Sierra Club regarding various facilities, including Columbia. Sierra Club has stipulated to a dismissal of its lawsuit, without prejudice, while the parties attempt to reach a final settlement. The parties are currently negotiating a consent decree based upon those general terms, which may change during the negotiations. Once the parties agree to final terms, the court must approve the settlement agreement before it becomes final and effective. 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 discussions. 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 of the settlement discussions.

**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 September 30, 2012, MGE has outstanding a $3.9 million interest in these receivables. MGE retains the servicing responsibility for these receivables. As of September 30, 2012, the servicing asset recognized by MGE is $0.2 million.

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 September 30, 2012, 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 2012 and the next four years on the loans are:

| *(In thousands)* | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Chattel Paper.................... | $ 126 | $ 669 | $ 484 | $ 796 | $ 721 |

**c. Purchase Power Agreement Contract Dispute - MGE Energy and MGE.**

MGE is seeking resolution to a contract dispute regarding its Purchase Power Agreement with Riverside Energy Center LLC, a Calpine subsidiary, for capacity and energy from the Riverside Energy Center located in Beloit, Wisconsin. MGE declared the PPA terminated. Any savings in capacity costs that ultimately result from the termination of the Riverside PPA will flow through to the Company's customers. MGE is currently deferring amounts equal to the capacity payments MGE would be making under the terms of the Riverside PPA if it were still in effect. This deferral will create a liability to MGE's customers for a future credit, assuming MGE's right to terminate the PPA is ultimately upheld. If MGE does not prevail in the dispute, the capacity payment deferred will be paid to Riverside Energy Center, LLC.

**d. 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.

**e. 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 September 30, 2012, the future commitments related to these purchase contracts were as follows:

| *(In thousands)* | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Coal[(a)] | $ 2,483 | $ 21,884 | $ 9,459 | $ 6,340 | $ 1,623 |
| Natural gas supply[(b)] | 12,872 | 13,192 | - | - | - |
| Purchase power[(c)] | 39,266 | 51,455 | 49,372 | 47,523 | 48,491 |
| | $ 54,621 | $ 86,531 | $ 58,831 | $ 53,863 | $ 50,114 |

*(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) These commitments include market-based pricing. Management expects to recover these costs in future customer rates.*

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

**f. 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 September 30, 2012, MGE has spent $7.9 million related to these projects and has outstanding agreements to purchase $0.6 million in smart grid related products for the remainder of 2012 and $1.3 million in 2013.

**g. Other Commitments - MGE Energy.**

On January 31, 2012, MGE Energy entered a subscription agreement to invest in a nonpublic venture capital fund. From time to time, this entity will require capital infusions from its investors. MGE Energy has committed to contribute $2.0 million in capital for such infusions. The timing of these infusions is dependent on the needs of the investee and is therefore uncertain at this time.

## 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:

| | September 30, 2012 | December 31, 2011 |
|---|---|---|
| Commodity derivative contracts | 440,320 MWh | 482,545 MWh |
| Commodity derivative contracts | 4,170,000 Dth | 4,030,000 Dth |
| FTRs | 4,069 MW | 2,382 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. At September 30, 2012, MGE Energy and MGE did not have any cash collateral netted against the net derivative positions. At December 31, 2011, MGE Energy and MGE had $3.0 million in collateral that was netted against the net derivative positions with counterparties.

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 September 30, 2012, the fair value of exchange traded derivatives and FTRs exceeded their cost basis by $1.8 million. At December 31, 2011, the cost basis of exchange traded derivatives and FTRs exceeded their fair value by $2.8 million.

MGE has also entered into 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 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 September 30, 2012, and December 31, 2011, reflects a loss position of $77.1 million and $39.5 million, respectively. The actual fuel cost will be recognized in purchased power expense in the month of purchase.

The following table summarizes the fair value of the derivative instruments on the 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.

| | Asset Derivatives | | | Liability Derivatives | | |
|---|---|---|---|---|---|---|
| *(In thousands)* | Balance Sheet Location | | Fair Value | Balance Sheet Location | | Fair Value |
| **September 30, 2012** | | | | | | |
| Commodity derivative contracts | Other current assets | $ | 1,463 | Derivative liability (current) | $ | 245 |
| Commodity derivative contracts | Other deferred charges | | 114 | Derivative liability (long-term) | | 60 |
| FTRs | Other current assets | | 561 | Derivative liability (current) | | - |
| Ten-year PPA | N/A | | N/A | Derivative liability (current) | | 9,600 |
| Ten-year PPA | N/A | | N/A | Derivative liability (long-term) | | 67,490 |
| **December 31, 2011** | | | | | | |
| Commodity derivative contracts | Other current assets | $ | 177 | Derivative liability (current) | $ | 3,060 |
| Commodity derivative contracts | Other deferred charges | | 92 | Derivative liability (long-term) | | 231 |
| FTRs | Other current assets | | 186 | Derivative liability (current) | | - |
| Ten-year PPA | N/A | | N/A | Derivative liability (current) | | 4,600 |
| Ten-year PPA | N/A | | N/A | Derivative liability (long-term) | | 34,920 |

The following tables summarize the unrealized and realized gains (losses) related to the derivative instruments on the balance sheet at September 30, 2012 and 2011, and the income statement for the three and nine months ended September 30, 2012 and 2011.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| *(In thousands)* | Current and long-term regulatory asset | Other current assets | Current and long-term regulatory asset | Other current assets |
| **Three Months Ended September 30:** | | | | |
| Balance at July 1, | $ 79,362 | $ 718 | $ 22,604 | $ 1,001 |
| Change in unrealized loss | (468) | - | 3,839 | - |
| Realized loss reclassified to a deferred account | (223) | 223 | (210) | 210 |
| Realized gain (loss) reclassified to income statement | (3,414) | (161) | 350 | (233) |
| Balance at September 30, | $ 75,257 | $ 780 | $ 26,583 | $ 978 |
| **Nine Months Ended September 30:** | | | | |
| Balance at January 1, | $ 42,356 | $ 1,604 | $ 19,230 | $ 1,411 |
| Change in unrealized loss | 42,633 | - | 7,775 | - |
| Realized loss reclassified to a deferred account | (3,103) | 3,103 | (1,484) | 1,484 |
| Realized gain (loss) reclassified to income statement | (6,629) | (3,927) | 1,062 | (1,917) |
| Balance at September 30, | $ 75,257 | $ 780 | $ 26,583 | $ 978 |

| | Realized losses (gains) | | |
|---|---|---|---|
| *(In thousands)* | Regulated gas revenues | Fuel for electric generation/ purchased power | Cost of gas sold |
| **Three Months Ended September 30, 2012:** | | | |
| Commodity derivative contracts | $ - | $ 176 | $ - |
| FTRs | - | (256) | - |
| Ten-year PPA | - | 3,655 | - |
| **Three Months Ended September 30, 2011:** | | | |
| Commodity derivative contracts | $ - | $ (94) | $ - |
| FTRs | - | (23) | - |
| Ten-year PPA | - | - | - |
| **Nine Months Ended September 30, 2012:** | | | |
| Commodity derivative contracts | $ - | $ 2,685 | $ 3,090 |
| FTRs | - | (93) | - |
| Ten-year PPA | - | 4,874 | - |
| **Nine Months Ended September 30, 2011:** | | | |
| Commodity derivative contracts | $ - | $ (465) | $ 1,315 |
| FTRs | - | 5 | - |
| 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 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 September 30, 2012, 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 September 30, 2012, and December 31, 2011, 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 September 30, 2012, no counterparties have defaulted.

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

**a. Rate Proceedings.**

On March 23, 2012, MGE filed an application with the PSCW requesting a 5.8% increase to electric rates and a 2.6% increase to gas rates. The proposed electric increase will cover costs for new environmental equipment at Columbia, final construction costs for the Elm Road Units (including the prudence of construction costs incurred above a previously approved cap), transmission reliability enhancements, and purchased power costs. MGE has requested that these rates become effective January 1, 2013.

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.

On January 12, 2011, the PSCW authorized MGE to increase 2011 rates for retail electric customers by 2.3% or $8.0 million and to increase gas rates by 1.0% or $1.9 million. The increase in retail electric rates is driven by costs for MGE's share of the Elm Road Units. Pursuant to the provisions of this rate order, the fuel rules bandwidth effective January 1, 2011, will be plus or minus 2%. See below for further description of fuel rules. Authorized return on common stock equity was set at 10.3% based on a 58.1% utility common equity.

**b. Fuel Rules.**

The PSCW approved new fuel rules that became effective January 1, 2011. The new 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. 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 September 30, 2012, MGE has deferred $5.9 million (for credit back to customers) of electric fuel-related savings that are outside the 98% range authorized by the PSCW in the most recent rate order.

## 11. Fair Value of Financial Instruments - MGE Energy and MGE.

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

At September 30, 2012, and December 31, 2011, 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 September 30, 2012, and December 31, 2011. Since the long-term debt is not traded in an active market, it is classified as Level 2 (see discussion regarding the fair value level hierarchy below in section b). The estimated fair market value, of MGE Energy's and MGE's financial instruments are as follows:

| | September 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| *(In thousands)* | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **MGE Energy** | | | | |
| *Assets:* | | | | |
| Cash and cash equivalents | $ 59,203 | $ 59,203 | $ 41,169 | $ 41,169 |
| *Liabilities:* | | | | |
| Long-term debt* | 362,473 | 436,747 | 364,473 | 432,515 |
| **MGE** | | | | |
| *Assets:* | | | | |
| Cash and cash equivalents | 29,536 | 29,536 | 13,898 | 13,898 |
| *Liabilities:* | | | | |
| Long-term debt* | 362,473 | 436,747 | 364,473 | 432,515 |

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

### b. Recurring Fair Value Measurements.

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.

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

| | Fair Value as of September 30, 2012 | | | |
|---|---|---|---|---|
| *(In thousands)* | Total | Level 1 | Level 2 | Level 3 |
| **MGE Energy** | | | | |
| Assets: | | | | |
| Exchange-traded investments | $ 409 | $ 409 | $ - | $ - |
| Total Assets | $ 409 | $ 409 | $ - | $ - |
| Liabilities: | | | | |
| Derivatives, net | $ 75,257 | $ (858) | $ - | $ 76,115 |
| Deferred compensation | 1,922 | - | 1,922 | - |
| Total Liabilities | $ 77,179 | $ (858) | $ 1,922 | $ 76,115 |
| **MGE** | | | | |
| Assets: | | | | |
| Exchange-traded investments | $ 138 | $ 138 | $ - | $ - |
| Total Assets | $ 138 | $ 138 | $ - | $ - |
| Liabilities: | | | | |
| Derivatives, net | $ 75,257 | $ (858) | $ - | $ 76,115 |
| Deferred compensation | 1,922 | - | 1,922 | - |
| Total Liabilities | $ 77,179 | $ (858) | $ 1,922 | $ 76,115 |

No transfers were made in or out of Level 1 or Level 2 for the nine months ended September 30, 2012.

| | Fair Value as of December 31, 2011 | | | |
|---|---|---|---|---|
| *(In thousands)* | Total | Level 1 | Level 2 | Level 3 |
| **MGE Energy** | | | | |
| Assets: | | | | |
| Exchange-traded investments | $ 350 | $ 350 | $ - | $ - |
| Total Assets | $ 350 | $ 350 | $ - | $ - |
| Liabilities: | | | | |
| Derivatives, net[(a)] | $ 42,356 | $ 1,695 | $ - | $ 40,661 |
| Deferred compensation[(b)] | 1,725 | - | 1,725 | - |
| Total Liabilities | $ 44,081 | $ 1,695 | $ 1,725 | $ 40,661 |
| **MGE** | | | | |
| Assets: | | | | |
| Exchange-traded investments | $ 188 | $ 188 | $ - | $ - |
| Total Assets | $ 188 | $ 188 | $ - | $ - |
| Liabilities: | | | | |
| Derivatives, net[(a)] | $ 42,356 | $ 1,695 | $ - | $ 40,661 |
| Deferred compensation[(b)] | 1,725 | - | 1,725 | - |
| Total Liabilities | $ 44,081 | $ 1,695 | $ 1,725 | $ 40,661 |

*(a) These amounts are shown gross and exclude $3.0 million of collateral that was posted against derivative positions with counterparties.*

*(b) The deferred compensation liability at December 31, 2011, was transferred from Level 1 to Level 2.*

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 party 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 with 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.

This model is prepared by members of the 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 | 96.8 % |
| Off peak | 94.8 % |
| Counterparty fuel mix: | |
| Internal generation | 49 % - 65 % |
| Purchased power | 51 % - 35 % |

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 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.

| *(In thousands)* | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Beginning balance, | $ (79,580) | $ (22,983) | $ (40,661) | $ (19,216) |
| Realized and unrealized gains (losses): | | | | |
| Included in regulatory liabilities (assets) | 3,465 | (2,927) | (35,455) | (6,694) |
| Included in other comprehensive income | - | - | - | - |
| Included in earnings | (3,422) | 182 | (6,659) | 815 |
| Included in current assets | - | (7) | (77) | (66) |
| Purchases | 5,864 | 178 | 7,764 | 342 |
| Sales | 45 | - | 77 | - |
| Issuances | - | - | - | - |
| Settlements | (2,487) | (353) | (1,104) | (1,091) |
| Transfers in and/or out of Level 3 | - | - | - | - |
| Balance as of September 30, | $ (76,115) | $ (25,910) | $ (76,115) | $ (25,910) |
| Total gains (losses) included in earnings attributed to the change in unrealized gains (losses) related to assets and liabilities held at September 30,[d] | $ - | $ - | $ - | $ - |

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 *(d)*.

| *(In thousands)* | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Purchased Power Expense | $ (3,422) | $ 182 | $ (6,659) | $ 815 |
| Cost of Gas Sold Expense | - | - | - | - |
| Regulated Gas Revenues | - | - | - | - |
| Total | $ (3,422) | $ 182 | $ (6,659) | $ 815 |

*(d) 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. Fair Value Measurements and Disclosures.

In May 2011, the FASB issued authoritative guidance within the Codification's Fair Value Measurements and Disclosures topic that provides guidance on additional disclosures about fair value measurements, specifically related to Level 3 assets and liabilities. This authoritative guidance became effective January 1, 2012. The authoritative guidance did not have any financial impact, but required additional disclosures. See Footnote 11 for additional information.

### b. Presentation of Comprehensive Income.

In June 2011, the FASB issued authoritative guidance within the Codification's Comprehensive Income topic that provides guidance on presentation of comprehensive income. Comprehensive income will be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This authoritative guidance became effective January 1, 2012. The authoritative guidance had an effect on our financial statement presentation of comprehensive income. See the Statement of Comprehensive Income for additional information.

**c. 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. This authoritative guidance will become effective January 1, 2013. The authoritative guidance will not have a financial impact, but will require additional disclosures.

**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 2011 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:

| *(In thousands)* **MGE Energy** | Electric | Gas | Non-Regulated Energy | Transmission Investment | All Others | Consolidation/ Elimination Entries | Consolidated Total |
|---|---|---|---|---|---|---|---|
| ***Three Months Ended September 30, 2012*** | | | | | | | |
| Operating revenues | $ 118,914 | $ 16,587 | $ 2,337 | $ - | $ - | $ - | $ 137,838 |
| Interdepartmental revenues | 159 | 4,658 | 8,679 | - | - | (13,496) | - |
| Total operating revenues | 119,073 | 21,245 | 11,016 | - | - | (13,496) | 137,838 |
| Depreciation and amortization | (6,530) | (1,399) | (1,777) | - | - | - | (9,706) |
| Other operating expenses | (78,823) | (22,675) | (36) | - | (206) | 13,496 | (88,244) |
| Operating income (loss) | 33,720 | (2,829) | 9,203 | - | (206) | - | 39,888 |
| Other income, net | 342 | 97 | - | 2,280 | 137 | - | 2,856 |
| Interest (expense) income, net | (2,535) | (715) | (1,631) | - | 32 | - | (4,849) |
| Income (loss) before taxes | 31,527 | (3,447) | 7,572 | 2,280 | (37) | - | 37,895 |
| Income tax (provision) benefit | (11,873) | 1,565 | (3,039) | (909) | 3 | - | (14,253) |
| Net income (loss) | $ 19,654 | $ (1,882) | $ 4,533 | $ 1,371 | $ (34) | $ - | $ 23,642 |
| ***Three Months Ended September 30, 2011*** | | | | | | | |
| Operating revenues | $ 114,963 | $ 17,249 | $ 1,360 | $ - | $ - | $ - | $ 133,572 |
| Interdepartmental revenues | 163 | 5,083 | 9,582 | - | - | (14,828) | - |
| Total operating revenues | 115,126 | 22,332 | 10,942 | - | - | (14,828) | 133,572 |
| Depreciation and amortization | (7,144) | (1,377) | (1,775) | - | - | - | (10,296) |
| Other operating expenses | (78,118) | (23,422) | (44) | - | (186) | 14,828 | (86,942) |
| Operating income (loss) | 29,864 | (2,467) | 9,123 | - | (186) | - | 36,334 |
| Other income, net | 35 | 12 | - | 2,167 | 127 | - | 2,341 |
| Interest (expense) income, net | (2,747) | (775) | (1,660) | - | 40 | - | (5,142) |
| Income (loss) before taxes | 27,152 | (3,230) | 7,463 | 2,167 | (19) | - | 33,533 |
| Income tax (provision) benefit | (9,944) | 1,350 | (2,994) | (870) | (37) | - | (12,495) |
| Net income (loss) | $ 17,208 | $ (1,880) | $ 4,469 | $ 1,297 | $ (56) | $ - | $ 21,038 |
| ***Nine Months Ended September 30, 2012*** | | | | | | | |
| Operating revenues | $ 305,189 | $ 92,235 | $ 6,894 | $ - | $ - | $ - | $ 404,318 |
| Interdepartmental revenues | 387 | 10,721 | 26,032 | - | - | (37,140) | - |
| Total operating revenues | 305,576 | 102,956 | 32,926 | - | - | (37,140) | 404,318 |
| Depreciation and amortization | (19,554) | (4,158) | (5,330) | - | - | - | (29,042) |
| Other operating expenses | (223,876) | (94,162) | (85) | - | (880) | 37,140 | (281,863) |
| Operating income (loss) | 62,146 | 4,636 | 27,511 | - | (880) | - | 93,413 |
| Other income, net | 602 | 170 | - | 6,764 | 439 | - | 7,975 |
| Interest (expense) income, net | (7,727) | (2,179) | (4,915) | - | 104 | - | (14,717) |
| Income (loss) before taxes | 55,021 | 2,627 | 22,596 | 6,764 | (337) | - | 86,671 |
| Income tax (provision) benefit | (20,300) | (740) | (9,069) | (2,719) | 117 | - | (32,711) |
| Net income (loss) | $ 34,721 | $ 1,887 | $ 13,527 | $ 4,045 | $ (220) | $ - | $ 53,960 |
| ***Nine Months Ended September 30, 2011*** | | | | | | | |
| Operating revenues | $ 291,804 | $ 119,748 | $ 3,884 | $ - | $ - | $ - | $ 415,436 |
| Interdepartmental revenues | 391 | 8,247 | 28,559 | - | - | (37,197) | - |
| Total operating revenues | 292,195 | 127,995 | 32,443 | - | - | (37,197) | 415,436 |
| Depreciation and amortization | (21,173) | (4,246) | (5,250) | - | - | - | (30,669) |
| Other operating expenses | (218,556) | (112,192) | (138) | - | (649) | 37,197 | (294,338) |
| Operating income (loss) | 52,466 | 11,557 | 27,055 | - | (649) | - | 90,429 |
| Other income, net | 68 | 21 | - | 6,434 | 357 | - | 6,880 |
| Interest (expense) income, net | (8,100) | (2,284) | (4,677) | - | 14 | - | (15,047) |
| Income (loss) before taxes | 44,434 | 9,294 | 22,378 | 6,434 | (278) | - | 82,262 |
| Income tax (provision) benefit | (15,666) | (3,532) | (8,981) | (2,592) | 53 | - | (30,718) |
| Net income (loss) | $ 28,768 | $ 5,762 | $ 13,397 | $ 3,842 | $ (225) | $ - | $ 51,544 |

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

| *(In thousands)* **MGE** | Electric | Gas | Non-Regulated Energy | Transmission Investment | Consolidation/ Elimination Entries | Consolidated Total |
|---|---|---|---|---|---|---|
| ***Three Months Ended September 30, 2012*** | | | | | | |
| Operating revenues | $ 118,914 | $ 16,587 | $ 2,337 | $ - | $ - | $ 137,838 |
| Interdepartmental revenues | 159 | 4,658 | 8,679 | - | (13,496) | - |
| Total operating revenues | 119,073 | 21,245 | 11,016 | - | (13,496) | 137,838 |
| Depreciation and amortization | (6,530) | (1,399) | (1,777) | - | - | (9,706) |
| Other operating expenses* | (90,946) | (21,180) | (3,075) | - | 13,496 | (101,705) |
| Operating income (loss)* | 21,597 | (1,334) | 6,164 | - | - | 26,427 |
| Other income, net* | 592 | 167 | - | 1,371 | - | 2,130 |
| Interest expense, net | (2,535) | (715) | (1,631) | - | - | (4,881) |
| Net income (loss) | 19,654 | (1,882) | 4,533 | 1,371 | - | 23,676 |
| Less: Net income attributable to noncontrolling interest, net of tax | - | - | - | - | (6,153) | (6,153) |
| Net income (loss) attributable to MGE | $ 19,654 | $ (1,882) | $ 4,533 | $ 1,371 | $ (6,153) | $ 17,523 |
| ***Three Months Ended September 30, 2011*** | | | | | | |
| Operating revenues | $ 114,963 | $ 17,249 | $ 1,360 | $ - | $ - | $ 133,572 |
| Interdepartmental revenues | 163 | 5,083 | 9,582 | - | (14,828) | - |
| Total operating revenues | 115,126 | 22,332 | 10,942 | - | (14,828) | 133,572 |
| Depreciation and amortization | (7,144) | (1,377) | (1,775) | - | - | (10,296) |
| Other operating expenses* | (88,013) | (22,057) | (3,039) | - | 14,828 | (98,281) |
| Operating income (loss)* | 19,969 | (1,102) | 6,128 | - | - | 24,995 |
| Other (deductions) income, net* | (14) | (4) | - | 1,297 | - | 1,279 |
| Interest expense, net | (2,747) | (775) | (1,660) | - | - | (5,182) |
| Net income (loss) | 17,208 | (1,881) | 4,468 | 1,297 | - | 21,092 |
| Less: net income attributable to noncontrolling interest, net of tax | - | - | - | - | (6,010) | (6,010) |
| Net income (loss) attributable to MGE | $ 17,208 | $ (1,881) | $ 4,468 | $ 1,297 | $ (6,010) | $ 15,082 |
| ***Nine Months Ended September 30, 2012*** | | | | | | |
| Operating revenues | $ 305,189 | $ 92,235 | $ 6,894 | $ - | $ - | $ 404,318 |
| Interdepartmental revenues | 387 | 10,721 | 26,032 | - | (37,140) | - |
| Total operating revenues | 305,576 | 102,956 | 32,926 | - | (37,140) | 404,318 |
| Depreciation and amortization | (19,554) | (4,158) | (5,330) | - | - | (29,042) |
| Other operating expenses* | (244,303) | (94,938) | (9,154) | - | 37,140 | (311,255) |
| Operating income* | 41,719 | 3,860 | 18,442 | - | - | 64,021 |
| Other income, net* | 729 | 206 | - | 4,045 | - | 4,980 |
| Interest expense, net | (7,727) | (2,179) | (4,915) | - | - | (14,821) |
| Net income | 34,721 | 1,887 | 13,527 | 4,045 | - | 54,180 |
| Less: Net income attributable to noncontrolling interest, net of tax | - | - | - | - | (18,305) | (18,305) |
| Net income attributable to MGE | $ 34,721 | $ 1,887 | $ 13,527 | $ 4,045 | $ (18,305) | $ 35,875 |
| ***Nine Months Ended September 30, 2011*** | | | | | | |
| Operating revenues | $ 291,804 | $ 119,748 | $ 3,884 | $ - | $ - | $ 415,436 |
| Interdepartmental revenues | 391 | 8,247 | 28,559 | - | (37,197) | - |
| Total operating revenues | 292,195 | 127,995 | 32,443 | - | (37,197) | 415,436 |
| Depreciation and amortization | (21,173) | (4,246) | (5,250) | - | - | (30,669) |
| Other operating expenses* | (234,145) | (115,701) | (9,119) | - | 37,197 | (321,768) |
| Operating income* | 36,877 | 8,048 | 18,074 | - | - | 62,999 |
| Other (deductions) income, net* | (8) | (2) | - | 3,842 | - | 3,832 |
| Interest expense, net | (8,100) | (2,284) | (4,677) | - | - | (15,061) |
| Net income | 28,769 | 5,762 | 13,397 | 3,842 | - | 51,770 |
| Less: net income attributable to noncontrolling interest, net of tax | - | - | - | - | (17,935) | (17,935) |
| Net income attributable to MGE | $ 28,769 | $ 5,762 | $ 13,397 | $ 3,842 | $ (17,935) | $ 33,835 |

**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:

| (In thousands) MGE Energy | Utility Electric | | Gas | | Assets not Allocated | | Consolidated Nonregulated Energy | | Transmission Investment | | All Others | | Consolidation/ Elimination Entries | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Assets:* | | | | | | | | | | | | | | | |
| September 30, 2012 | $ | 875,477 | $ | 265,332 | $ | 34,926 | $ | 291,409 | $ | 60,236 | $ | 403,261 | $ | (365,985) | $ 1,564,656 |
| December 31, 2011 | | 794,738 | | 285,702 | | 32,882 | | 299,421 | | 57,006 | | 401,862 | | (412,729) | 1,458,882 |
| *Capital Expenditures:* | | | | | | | | | | | | | | | |
| Nine Months Ended September 30, 2012 | $ | 55,518 | $ | 9,749 | $ | - | $ | 642 | $ | - | $ | - | $ | - | $ 65,909 |
| Year ended Dec. 31, 2011 | | 47,206 | | 15,830 | | - | | 2,140 | | - | | - | | - | 65,176 |

| (In thousands) MGE | Utility Electric | | Gas | | Assets not Allocated | | Consolidated Nonregulated Energy | | Transmission Investment | | Elimination Entries | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Assets:* | | | | | | | | | | | | | |
| September 30, 2012 | $ | 875,477 | $ | 265,332 | $ | 34,919 | $ | 291,359 | $ | 60,236 | $ | 10,740 | $ 1,538,063 |
| December 31, 2011 | | 794,738 | | 285,702 | | 32,882 | | 299,171 | | 57,006 | | (35,706) | 1,433,793 |
| *Capital Expenditures:* | | | | | | | | | | | | | |
| Nine Months Ended September 30, 2012 | $ | 55,518 | $ | 9,749 | $ | - | $ | 642 | $ | - | $ | - | $ 65,909 |
| Year ended Dec. 31, 2011 | | 47,206 | | 15,830 | | - | | 2,140 | | - | | - | 65,176 |

## 14. Subsequent Events - MGE Energy and MGE.

### ATC Capital Contribution.

On October 31, 2012, MGE Transco made a voluntary $0.4 million capital contribution to ATC.

## 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 139,000 customers in Dane County, Wisconsin, including the city of Madison, and purchases and distributes natural gas to approximately 144,000 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 undivided 8.33% ownership interest in two 615 MW 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 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 2011 Annual Report on Form 10-K and in this Report.

For the three months ended September 30, 2012, MGE Energy's earnings were $23.6 million or $1.02 per share compared to $21.0 million or $0.91 per share for the same period in the prior year. MGE's earnings for the three months ended September 30, 2012, were $17.5 million compared to $15.1 million for the same period in the prior year.

For the nine months ended September 30, 2012, MGE Energy's earnings were $54.0 million or $2.33 per share compared to $51.5 million or $2.23 per share for the same period in the prior year. MGE's earnings for the nine months ended September 30, 2012, were $35.9 million compared to $33.8 million for the same period in the prior year.

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

| *(In thousands)* | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| Business Segment: | 2012 | 2011 | 2012 | 2011 |
| Electric Utility | $ 19,654 | $ 17,208 | $ 34,721 | $ 28,768 |
| Gas Utility | (1,882) | (1,880) | 1,887 | 5,762 |
| Nonregulated Energy | 4,533 | 4,469 | 13,527 | 13,397 |
| Transmission Investment | 1,371 | 1,297 | 4,045 | 3,842 |
| All Other | (34) | (56) | (220) | (225) |
| Net Income | $ 23,642 | $ 21,038 | $ 53,960 | $ 51,544 |

Our net income during the three months ended September 30, 2012, primarily reflects the effects of the following factor:

- A 3.8% increase in retail electric revenues, driven by increased residential customer demand primarily as a result of warmer-than-normal weather. Cooling degree days (a measure for determining the impact of weather during the cooling season) increased by 19% compared to the prior period.

Our net income during the nine months ended September 30, 2012, primarily reflects the effects of the following factors:

- A 4.9% increase in retail electric revenues reflecting, in part, increased customer demand as a result of warmer-than-normal weather. Cooling degree days (a measure for determining the impact of weather during the cooling season) increased by 32% compared to the prior period.

- An 11.8% decrease in gas sales reflecting lower customer demand due to a milder winter. Heating degree days (a measure for determining the impact of weather during the heating season) decreased by 25% compared to the prior period.

During the first nine months of 2012, 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. MGE expects to incur capital expenditures as follows: $18 million for the remainder of 2012, $68 million in 2013, and $12 million in 2014. As of September 30, 2012, MGE has accumulated $42.3 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 $38.0 million in 2012. MGE has recognized $0.7 million (after tax) in AFUDC equity related to this project for the nine months ended September 30, 2012.

Rate Filing: On March 23, 2012, MGE filed an application with the PSCW requesting a 5.8% increase to electric rates and a 2.6% increase to gas rates. The proposed electric increase will cover costs for new environmental equipment at Columbia, final construction costs for the Elm Road Units (including the prudence of construction costs incurred above a previously approved cap), transmission reliability enhancements, and purchased power costs. MGE has requested that these rates become effective January 1, 2013. See Footnote 21 in the 2011 Annual Report Form 10-K for additional information on the construction costs for the Elm Road Units.

ATC: MGE Transco contributed $1.8 million for voluntary capital contributions to ATC for the nine months ended September 30, 2012.

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 September 30, 2012, MGE has spent $7.9 million related to these projects. Of this amount, $1.9 million was incurred during the nine months ended September 30, 2012. MGE also has outstanding agreements to purchase $0.6 million in smart grid related products for the remainder of 2012 and $1.3 million in 2013.

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

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.

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 $115 million for MGE Energy (including MGE) and $75 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 September 30, 2012 and 2011*

### 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:

| | Revenues | | | Sales (kWh) | | |
|---|---|---|---|---|---|---|
| | Three Months Ended September 30, | | | Three Months Ended September 30, | | |
| *(in thousands, except cooling degree days)* | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Residential | $ 42,652 | $ 39,176 | 8.9 % | 264,217 | 251,426 | 5.1 % |
| Commercial | 60,317 | 59,131 | 2.0 % | 507,696 | 516,744 | (1.8)% |
| Industrial | 5,468 | 5,588 | (2.1)% | 65,994 | 71,591 | (7.8)% |
| Other-retail/municipal | 11,356 | 11,497 | (1.2)% | 118,548 | 132,721 | (10.7)% |
| Total retail | 119,793 | 115,392 | 3.8 % | 956,455 | 972,482 | (1.6)% |
| Sales to the market | 390 | 606 | (35.6)% | 2,802 | 4,376 | (36.0)% |
| Adjustments to revenues | (1,269) | (1,035) | (22.6)% | - | - | - % |
| Total | $ 118,914 | $ 114,963 | 3.4 % | 959,257 | 976,858 | (1.8)% |
| Cooling degree days (normal 452) | | | | 729 | 612 | 19.1 % |

Electric operating revenues increased $4.0 million or 3.4% for the three months ended September 30, 2012, due to the following:

| *(In millions)* | |
|---|---|
| Rate changes | $ 6.3 |
| Volume | (1.9) |
| Sales to the market | (0.2) |
| Adjustments to revenues | (0.2) |
| Total | $ 4.0 |

- *Rate changes*. Rates charged to retail customers for the three months ended September 30, 2012, were 5.6% or $6.3 million higher than those charged during the same period in the prior year.

  In December 2011, the PSCW authorized MGE to increase 2012 rates for retail electric customers by 4.3% or $15.7 million. The increase in retail electric rates is 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.

- *Volume*. During the three months ended September 30, 2012, there was a 1.6% decrease in total retail sales volumes compared to the same period in the prior year.

- *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.

- *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 decreased $0.3 million or 1.6% during the three months ended September 30, 2012, compared to the same period in the prior year. Internal electric generation costs decreased $1.3 million as a result of a 7.6% decrease in the per-Unit cost (largely due to lower natural gas prices), which was offset by an increase of $1.0 million due to a 6.5% increase in volume.

Excluding the fuel rules adjustments discussed below, purchased power expense decreased $0.4 million during the three months ended September 30, 2012, compared to the same period in the prior year. A 16.9% decrease in the volume of purchased power from third parties lowered expense by $2.6 million, which was offset by a $2.2 million or 17.2% increase in the per-Unit cost of purchased power.

The PSCW has adopted new fuel rules effective January 1, 2011, that require MGE to defer electric fuel-related costs that fall outside a 2% cost tolerance band around the amount used in the most recent rate proceeding. Any fuel rules adjustments are reflected in purchased power expense. During the third quarter of 2012, MGE's actual fuel costs fell below the lower end of this tolerance band which resulted in MGE deferring $3.2 million in fuel-related cost savings to be returned to customers and increased purchased power costs. Any over/under recovery of the deferred costs is determined on an annual basis and adjusted in future billings to customers. In the third quarter of 2011, MGE reversed $2.7 million of incremental fuel-related costs deferred as of June 30, 2011, and increased purchased power costs (it was determined no fuel cost recovery would come from customers under the fuel rules). For the third quarter of 2012 compared to the prior year, the impact of these fuel rules adjustments was to create a difference in purchased power expense of $0.5 million. After combining the fuel rules adjustments with the actual savings discussed above, purchased power expense increased $0.1 million ($0.5 million fuel rules difference less the $0.4 million decrease discussed above) during the three months ended September 30, 2012, compared to the prior year.

***Electric operating and maintenance expenses***

Electric operating and maintenance expenses increased $1.6 million during the three months ended September 30, 2012, compared to the same period in 2011. The following changes contributed to the net change:

| *(In millions)* | | |
|---|---|---|
| Increased administrative and general costs | $ | 1.5 |
| Increased customer service costs | | 0.2 |
| Other | | (0.1) |
| Total | $ | 1.6 |

For the three months ended September 30, 2012, increased administrative and general costs are primarily due to increased pension costs and increased customer service costs are due to increased energy conservation costs.

***Electric depreciation expense***

Electric depreciation expense decreased $0.6 million for the three months ended September 30, 2012, compared to the same period in the prior year. This decrease is related to the retirement of Blount assets at the end of 2011 due to the switch from operating with coal to natural gas.

## 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:

| *(In thousands, except HDD and average rate per therm of retail customer)* | Revenues | | | Therms Delivered | | |
|---|---|---|---|---|---|---|
| | Three Months Ended September 30, | | | Three Months Ended September 30, | | |
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Residential | $ 8,004 | $ 8,614 | (7.1)% | 5,658 | 5,939 | (4.7)% |
| Commercial/Industrial | 7,960 | 8,001 | (0.5)% | 17,175 | 13,008 | 32.0 % |
| Total retail | 15,964 | 16,615 | (3.9)% | 22,833 | 18,947 | 20.5 % |
| Gas transportation | 515 | 506 | 1.8 % | 6,310 | 6,367 | (0.9)% |
| Other revenues | 108 | 128 | (15.6)% | - | - | - % |
| Total | $ 16,587 | $ 17,249 | (3.8)% | 29,143 | 25,314 | 15.1 % |
| Heating degree days (normal 182) | | | | 212 | 216 | (1.9)% |
| Average Rate Per Therm of Retail Customer | $ 0.699 | $ 0.877 | (20.3)% | | | |

Gas revenues decreased $0.7 million or 3.8% for the three months ended September 30, 2012. These changes are related to the following factors:

| *(In millions)* | |
|---|---|
| Gas costs/rates | $ (4.1) |
| Gas deliveries | 3.4 |
| Total | $ (0.7) |

- *Gas costs/rates*. The average retail rate per therm for the three months ended September 30, 2012, decreased 20.3% compared to the same period in 2011, reflecting lower natural gas commodity costs.

- *Retail gas deliveries*. For the three months ended September 30, 2012, retail gas deliveries increased 20.5% compared to the same period in 2011.

### *Cost of gas sold*

For the three months ended September 30, 2012, cost of gas sold decreased by $0.8 million, compared to the same period in the prior year. The volume of gas purchased increased 22.8%, which resulted in $1.8 million of increased expense. However, the cost per therm of natural gas decreased 9.6%, which resulted in $2.6 million of decreased expense.

### *Gas operating and maintenance expenses*

Gas operating and maintenance expenses increased by $0.6 million for the three months ended September 30, 2012, compared to the same period in 2011. The following changes contributed to the net change:

| *(In millions)* | |
|---|---|
| Increased administrative and general costs | $ 0.5 |
| Increased customer service costs | 0.1 |
| Increased distribution costs | 0.1 |
| Decreased customer accounts costs | (0.1) |
| Total | $ 0.6 |

## Nonregulated Energy Operations - MGE Energy and MGE

For both the three months ended September 30, 2012 and 2011, net income at the nonregulated energy operations segment was $4.5 million. The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power, 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 September 30, 2012, other income at the transmission investment segment was $2.3 million compared to $2.2 million for the same period in 2011. 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 effective income tax rate for the three months ended September 30, 2012, is 37.6% compared to 37.3% for the same period in 2011, and MGE's effective income tax rate for the three months ended September 30, 2012, is 37.6% compared to 37.1% for the same period in 2011.

### 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 September 30, | |
|---|---|---|
| *(in millions)* | 2012 | 2011 |
| MGE Power Elm Road | $ 3.7 | $ 3.7 |
| MGE Power West Campus | $ 1.9 | $ 1.9 |
| MGE Transco | $ 0.6 | $ 0.5 |

## *Nine Months Ended September 30, 2012 and 2011*

### 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:

| | Revenues | | | Sales (kWh) | | |
|---|---|---|---|---|---|---|
| | Nine Months Ended September 30, | | | Nine Months Ended September 30, | | |
| *(in thousands, except cooling degree days)* | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Residential | $ 102,481 | $ 97,225 | 5.4 % | 646,238 | 638,925 | 1.1 % |
| Commercial | 160,309 | 152,751 | 4.9 % | 1,400,390 | 1,398,161 | 0.2 % |
| Industrial | 15,130 | 14,993 | 0.9 % | 191,363 | 201,815 | (5.2)% |
| Other-retail/municipal | 29,886 | 28,583 | 4.6 % | 334,097 | 336,788 | (0.8)% |
| Total retail | 307,806 | 293,552 | 4.9 % | 2,572,088 | 2,575,689 | (0.1)% |
| Sales to the market | 1,144 | 1,489 | (23.2)% | 25,760 | 32,634 | (21.1)% |
| Adjustments to revenues | (3,761) | (3,237) | (16.2)% | - | - | - % |
| Total | $ 305,189 | $ 291,804 | 4.6 % | 2,597,848 | 2,608,323 | (0.4)% |
| | | | | | | |
| Cooling degree days (normal 622) | | | | 1,065 | 804 | 32.5 % |

Electric operating revenues increased $13.4 million or 4.6% for the nine months ended September 30, 2012, due to the following:

| *(In millions)* | |
|---|---|
| Rate changes | $ 14.7 |
| Volume | (0.4) |
| Sales to the market | (0.3) |
| Adjustments to revenues | (0.6) |
| Total | $ 13.4 |

- *Rate changes*. Rates charged to retail customers for the nine months ended September 30, 2012, were 5.0% or $14.7 million higher than those charged during the same period in the prior year.

  In December 2011, the PSCW authorized MGE to increase 2012 rates for retail electric customers by 4.3% or $15.7 million. The increase in retail electric rates is 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.

- *Volume*. During the nine months ended September 30, 2012, there was a 0.1% decrease in total retail sales volumes compared to the same period in the prior year.

- *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.

- *Adjustments to revenues.* The adjustments to revenues amount includes the elimination of carrying costs for Elm Road Units and the 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 decreased $2.6 million or 6.6% during the nine months ended September 30, 2012, compared to the same period in the prior year. Internal electric generation costs decreased $2.8 million as a result of a 7.2% decrease in the per-unit cost (largely due to lower natural gas prices), and higher generation volumes of 0.7% or $0.2 million.

Excluding the fuel rules adjustments discussed below, purchased power expense decreased $0.9 million during the nine months ended September 30, 2012, compared to the same period in the prior year, due to a 1.7% decrease in the volume of power purchased from third parties.

The PSCW has adopted new fuel rules effective January 1, 2011, that require MGE to defer electric fuel-related costs that fall outside a 2% cost tolerance band around the amount used in the most recent rate proceeding. Any fuel rules adjustments are reflected in purchased power expense. During the nine months ended September 30, 2012, MGE's actual fuel costs fell below the lower end of this tolerance band, which resulted in MGE deferring $5.9 million in fuel-related cost savings to be returned to customers and increased purchased power costs. Any over/under recovery of the deferred costs is determined on an annual basis and adjusted in future billings to customers. After combining the fuel rules adjustments with the actual savings discussed above, purchased power expense increased $5.0 million ($5.9 million fuel rules difference less the $0.9 million decrease discussed above) during the nine months ended September 30, 2012, compared to the prior year.

***Electric operating and maintenance expenses***

Electric operating and maintenance expenses increased $4.0 million during the nine months ended September 30, 2012, compared to the same period in 2011. The following changes contributed to the net change:

| *(In millions)* | | |
|---|---|---|
| Increased administrative and general costs | $ | 4.3 |
| Increased customer services costs | | 0.8 |
| Increased distribution costs | | 0.7 |
| Increased transmission costs | | 0.4 |
| Decreased production costs | | (2.2) |
| Total | $ | 4.0 |

For the nine months ended September 30, 2012, increased administrative and general costs are primarily due to increased pension costs. Increased customer service costs are due to higher energy conservation spending. Increased distribution costs are due to increased overhead line expenses. Production costs decreased primarily due to decreased costs at Columbia and the Elm Road Units.

***Electric depreciation expense***

Electric depreciation expense decreased $1.6 million for the nine months ended September 30, 2012, compared to the same period in the prior year. This decrease is related to the retirement of Blount assets at the end of 2011 due to the switch from operating with coal to natural gas.

**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:

| *(In thousands, except HDD and average rate per therm of retail customer)* | Revenues | | | Therms Delivered | | |
|---|---|---|---|---|---|---|
| | Nine Months Ended September 30, | | | Nine Months Ended September 30, | | |
| | 2012 | 2011 | % Change | 2012 | 2011 | % Change |
| Residential | $ 51,620 | $ 67,180 | (23.2)% | 51,246 | 64,827 | (20.9)% |
| Commercial/Industrial | 38,521 | 50,183 | (23.2)% | 72,743 | 75,265 | (3.4)% |
| Total retail | 90,141 | 117,363 | (23.2)% | 123,989 | 140,092 | (11.5)% |
| Gas transportation | 1,744 | 1,909 | (8.6)% | 22,726 | 26,287 | (13.5)% |
| Other revenues | 350 | 476 | (26.5)% | - | - | - % |
| Total | $ 92,235 | $ 119,748 | (23.0)% | 146,715 | 166,379 | (11.8)% |
| Heating degree days (normal 4,582) | | | | 3,581 | 4,805 | (25.5)% |
| Average Rate Per Therm of Retail Customer | $ 0.727 | $ 0.838 | (13.2)% | | | |

Gas revenues decreased $27.5 million or 23.0% for the nine months ended September 30, 2012. These changes are related to the following factors:

| *(In millions)* | |
|---|---|
| Gas costs/rates | $ (13.7) |
| Gas deliveries | (13.5) |
| Transportation and other effects | (0.3) |
| Total | $ (27.5) |

- *Retail gas deliveries*. For the nine months ended September 30, 2012, retail gas deliveries decreased 11.5% compared to the same period in 2011, as a result of milder weather during the winter months.

- *Gas costs/rates*. The average retail rate per therm for the nine months ended September 30, 2012, decreased 13.2% compared to the same period in 2011, reflecting lower natural gas commodity costs.

***Cost of gas sold***

For the nine months ended September 30, 2012, cost of gas sold decreased by $22.1 million, compared to the same period in the prior year. The volume of purchased gas decreased 12.0%, which resulted in $8.6 million of decreased expense. In addition, the cost per therm of natural gas decreased 21.3%, which resulted in $13.5 million of decreased expense.

***Gas operating and maintenance expenses***

Gas operating and maintenance expenses increased by $2.2 million for the nine months ended September 30, 2012, compared to the same period a year ago. The following changes contributed to the net change:

| *(In millions)* | |
|---|---|
| Increased administrative and general costs | $ 1.2 |
| Increased distribution costs | 0.4 |
| Increased customer service costs | 0.4 |
| Increased customer accounts costs | 0.2 |
| Total | $ 2.2 |

For the nine months ended September 30, 2012, increased administrative general costs are primarily due to increased pension costs.

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

For the nine months ended September 30, 2012 and 2011, net income at the nonregulated energy operations segment was $13.5 million and $13.4 million, respectively. The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power, 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 nine months ended September 30, 2012 and 2011, other income at the transmission investment segment was $6.8 million and $6.4 million, respectively. 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 effective income tax rate for the nine months ended September 30, 2012, is 37.7% compared to 37.3% for the same period in 2011, and MGE's effective income tax rate for the nine months ended September 30, 2012, is 37.7% compared to 37.3% for the same period in 2011.

**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:

| | Nine Months Ended September 30, | |
|---|---|---|
| *(in millions)* | 2012 | 2011 |
| MGE Power Elm Road | $ 11.1 | $ 10.9 |
| MGE Power West Campus | $ 5.6 | $ 5.6 |
| MGE Transco | $ 1.6 | $ 1.4 |

**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 nine months ended September 30, 2012, 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 2011 Annual Report on Form 10-K.

***Purchase Power Agreement Contract Dispute - MGE Energy and MGE***

MGE is seeking resolution to a contract dispute regarding its Purchase Power Agreement with Riverside Energy Center LLC, a Calpine subsidiary, for capacity and energy from the Riverside Energy Center located in Beloit, Wisconsin. MGE declared the PPA terminated. Any savings in capacity costs that ultimately result from the termination of the Riverside PPA will flow through to the Company's customers. MGE is currently deferring amounts equal to the capacity payments MGE would be making under the terms of the Riverside PPA if it were still in effect. This deferral will create a liability to MGE's customers for a future credit, assuming MGE's right to terminate the PPA is ultimately upheld. If MGE does not prevail in the dispute, the capacity payment deferred will be paid to Riverside Energy Center, LLC.

### *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 September 30, 2012, the future commitments related to these purchase contracts were as follows:

| *(In thousands)* | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Coal[(a)] | $ 2,483 | $ 21,884 | $ 9,459 | $ 6,340 | $ 1,623 |
| Natural gas supply[(b)] | 12,872 | 13,192 | - | - | - |
| Purchase Power[(c)] | 39,266 | 51,455 | 49,372 | 47,523 | 48,491 |
| | $ 54,621 | $ 86,531 | $ 58,831 | $ 53,863 | $ 50,114 |

(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) *These commitments include market-based pricing. Management expects to recover these costs in future customer rates.*

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

### *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 September 30, 2012, MGE has spent $7.9 million related to these projects and has outstanding agreements to purchase $0.6 million in smart grid related products for the remainder of 2012 and $1.3 million in 2013.

### *Other Commitments - MGE Energy*

On January 31, 2012, MGE Energy entered a subscription agreement to invest in a nonpublic venture capital fund. From time to time, this entity will require capital infusions from its investors. MGE Energy has committed to contribute $2.0 million in capital for such infusions. The timing of these infusions is dependent on the needs of the investee and is therefore uncertain at this time.

### *Long-term Debt - MGE Energy and MGE*

On April 2, 2012, MGE issued $28 million in principal amount of its 4.38% senior notes, due April 1, 2042. The Notes were issued pursuant to a Note Purchase Agreement. The Notes are unsecured and are not issued under, or governed by, MGE's Indenture dated as of September 1, 1998, which governs MGE's Medium-Term Notes. MGE used the net proceeds from the sale of the Notes, together with other available corporate funds, to repay and retire on April 3, 2012, its obligations under a Loan Agreement dated as of April 1, 2002 with the City of Madison, Wisconsin, under which MGE received the net proceeds from the issuance of $28 million aggregate principal amount of 5.875% Series 2002A, Industrial Development Revenue Bonds that were issued by the City of Madison for MGE's benefit. The 5.875% Series 2002A Bonds were redeemed and retired on April 3, 2012, at 100% of their principal amount plus accrued interest with the proceeds of that loan repayment. Any interest savings in 2012 will be deferred.

***Remarketing of 4.875% Series 2002B, Industrial Development Revenue Bonds - MGE Energy and MGE***

On April 2, 2012, $19.3 million of 4.875% Series 2002B, Industrial Development Revenue Bonds were remarketed at an interest rate of 3.45%. The net proceeds of the 4.875% Series 2002B Bonds were originally loaned to MGE pursuant to a Loan Agreement dated as of April 1, 2002 with the City of Madison, which issued the Series 2002B Bonds in 2002. MGE is responsible for the payment of principal, premium, if any, and interest on the Bonds. The 4.875% Series 2002B Bonds were originally issued bearing an interest rate of 4.875% per annum for a period that ended April 1, 2012, at which point the Bonds were subject to mandatory tender by their holders and remarketing. The Series 2002B Bonds were remarketed and carry an interest rate of 3.45% per annum, which is payable semi-annually on April 1 and October 1, until their maturity on October 1, 2027. The Series 2002B Bonds are redeemable on or after April 1, 2017, at a redemption price equal to 100% of the principal amount of the Bonds to be redeemed, plus accrued interest to the redemption date.

## *Liquidity and Capital Resources*

**Cash Flows**

The following summarizes cash flows for MGE Energy and MGE during the nine months ended September 30, 2012 and 2011:

| | MGE Energy | | MGE | |
|---|---|---|---|---|
| *(In thousands)* | 2012 | 2011 | 2012 | 2011 |
| Cash provided by/(used for): | | | | |
| Operating activities | $ 115,886 | $ 106,525 | $ 113,569 | $ 105,041 |
| Investing activities | (68,188) | (47,889) | (67,955) | (45,374) |
| Financing activities | (29,664) | (20,853) | (29,976) | (37,664) |

**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 nine months ended September 30, 2012, was $115.9 million, an increase of $9.4 million when compared to the same period in the prior year primarily related to lower income taxes as a result of the bonus depreciation related to ERGS.

MGE Energy's net income increased $2.4 million for the nine months ended September 30, 2012, when compared to the same period in the prior year.

The cash flows for the nine months ended September 30, 2012, reflect a $37.8 million benefit of lower taxes payable, compared to the same period in the prior year, primarily due to bonus depreciation related to ERGS.

Working capital accounts resulted in $22.4 million in cash used by operating activities for the nine months ended September 30, 2012, primarily due to increased prepaid taxes and decreased accounts payable, partially offset by decreased receivable – margin and decreased unbilled revenues. Working capital accounts resulted in $17.3 million in cash provided by operating activities for the nine months ended September 30, 2011, primarily due to decreased unbilled, decreased accounts receivable, and decreased prepaid taxes, partially offset by decreased accounts payable.

An increase in pension contribution resulted in an additional $1.9 million in cash used by operating activities for the nine months ended September 30, 2012, when compared to the same period in the prior year. These contributions include amounts to comply with the minimum funding standards of the Employee Retirement Income Security Act (ERISA) and the Pension Protection Act of 2006, as well as additional discretionary contributions.

***MGE***

Cash provided by operating activities for the nine months ended September 30, 2012, was $113.6 million, an increase of $8.5 million when compared to the same period in the prior year primarily related to lower income taxes as a result of the bonus depreciation related to ERGS.

Net income increased $2.4 million for the nine months ended September 30, 2012, when compared to the same period in the prior year.

The cash flows for the nine months ended September 30, 2012, reflect a $37.8 million benefit of lower taxes payable, compared to the same period in the prior year, primarily due to bonus depreciation related to ERGS.

Working capital accounts resulted in $24.5 million in cash used by operating activities for the nine months ended September 30, 2012, primarily due to increased prepaid taxes and decreased accounts payable, partially offset by decreased receivable – margin and decreased unbilled revenues. Working capital accounts resulted in $15.9 million in cash provided by operating activities for the nine months ended September 30, 2011, primarily due to decreased unbilled, decreased accounts receivable, and decreased prepaid taxes, partially offset by decreased accounts payable.

An increase in pension contribution resulted in an additional $1.9 million in cash used by operating activities for the nine months ended September 30, 2012, when compared to the same period in the prior year. These contributions include amounts to comply with the minimum funding standards of ERISA and the Pension Protection Act of 2006, as well as additional discretionary contributions.

**Cash Used for Investing Activities**

***MGE Energy***

MGE Energy's cash used for investing activities increased $20.3 million for the nine months ended September 30, 2012, when compared to the same period in the prior year.

Capital expenditures for the nine months ended September 30, 2012, were $65.9 million. This amount represents an increase of $21.1 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 $30.8 million.

Cash used for investing activities for the nine months ended September 30, 2011, also included land purchased for investing purposes of $2.2 million.

***MGE***

MGE's cash used for investing activities increased $22.6 million for the nine months ended September 30, 2012, when compared to the same period in the prior year.

Capital expenditures for the nine months ended September 30, 2012, were $65.9 million. This amount represents an increase of $21.1 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 $30.8 million.

**Cash Used for Financing Activities**

***MGE Energy***

Cash used for MGE Energy's financing activities was $29.7 million for the nine months ended September 30, 2012, compared to $20.9 million of cash used for the nine months ended September 30, 2011.

For the nine months ended September 30, 2012, dividends paid were $26.8 million compared to $26.2 million in the prior year. This increase was a result of a higher dividend per share ($1.161 vs. $1.133).

During the nine months ended September 30, 2012, MGE issued and retired $28.0 million of long-term debt. During the nine months ended September 30, 2011, MGE Power Elm Road issued $30.0 million of long-term debt.

For the nine months ended September 30, 2011, net short-term debt repayments were $22.5 million reflecting the use of proceeds from the MGE Power Elm Road long-term debt issue.

***MGE***

During the nine months ended September 30, 2012, cash used for MGE's financing activities was $30.0 million compared to $37.7 million of cash used by MGE's financing activities in the prior year.

Dividends paid from MGE to MGE Energy were $13.5 million for the nine months ended September 30, 2012, compared to $19.9 million in the prior year.

During the nine months ended September 30, 2012, MGE issued and retired $28.0 million of long-term debt. During the nine months ended September 30, 2011, MGE Power Elm Road issued $30.0 million of long-term debt.

Distributions to parent from noncontrolling interest were $15.5 million for the nine months ended September 30, 2012. As a result of the long-term debt financing by MGE Power Elm Road, distributions to parent from noncontrolling interest were $43.0 million for the nine months ended September 30, 2011. The proceeds from the financing were used to repay MGE Energy, which had been using its short-term credit facilities to help finance the Elm Road Units.

In addition, for the nine months ended September 30, 2011, net short-term debt repayments were $3.5 million.

**Capitalization Ratios**

MGE Energy's capitalization ratios were as follows:

| | MGE Energy | |
|---|---|---|
| | September 30, 2012 | December 31, 2011 |
| Common shareholders' equity | 61.5 % | 60.2 % |
| Long-term debt* | 38.5 % | 39.8 % |

**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 nine months ended September 30, 2012, capital expenditures for MGE Energy and MGE totaled $65.9 million, which included $65.3 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 expects to incur capital expenditures as follows: $18 million for the remainder of 2012, $68 million in 2013, and $12 million in 2014. As of September 30, 2012, MGE had incurred $35.1 million (excluding carrying costs) in construction expenditures at Columbia related to the project and had accrued $7.2 million in incurred, but unpaid capital expenditures. MGE has recognized $0.7 million (after tax) in AFUDC equity related to this project for the nine months ended September 30, 2012.

**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.

**Pension Plan Funding Stabilization**

On July 6, 2012, the Moving Ahead for Progress in the 21$^{st}$ Century Act (MAP-21) was signed and became law. The provisions in MAP-21 provide pension plan funding relief through interest rate stabilization and will increase Pension Benefit Guaranty Corporation premiums payable with respect to plans. MGE does not believe the law will have a significant impact on its pension funding policy.

**Environmental Matters**

The following discussion is limited to updates or developments in environmental matters that occurred during the nine months ended September 30, 2012. Further discussion of environmental matters is included in MGE Energy's and MGE's 2011 Annual Report on Form 10-K and Footnote 8.a. of Notes to Consolidated Financial Statements in this Report.

*Global climate change*

MGE is a producer of GHG emissions, primarily from the fossil fuel generating facilities it utilizes to meet customers' energy needs, as well as from its natural gas pipeline system and fleet vehicles. Climate change and the regulatory response to it could significantly affect our operations in a number of ways, including increased operating costs and capital expenditures, restrictions on energy supply options, permitting difficulties and more stringent emission limits. MGE management would expect to seek and receive rate recovery of such compliance costs, if and when required. MGE will continue to monitor proposed climate change legislation and regulation. MGE is currently complying with applicable greenhouse gas regulations and is actively monitoring current proposed and other potential greenhouse gas regulations from the EPA.

*GHG New Source Performance Standards for Electric Generating Units (EGU GHG NSPS)*
On March 27, 2012, the EPA proposed greenhouse gas (GHG) New Source Performance Standards (NSPS) for coal fired and natural gas combined cycle (NGCC) electric generation units (EGUs). The proposal applies to new EGUs only; the EPA has stated that it does not intend for these rules to apply to modified or existing units at this time. The proposed NSPS may be finalized within 2012 and is not anticipated to significantly affect MGE's existing generation units.

*Vacation of EPA's Cross State Air Pollution Rule (CSAPR) and Reinstatement of the Clean Air Interstate Rule (CAIR)*
EPA has so far promulgated three interstate air pollution rules [the $NO_x$ SIP Call, the Clean Air Interstate Rule (CAIR) and the Cross-State Air Pollution Rule (CSAPR)] which were each designed to reduce nitrogen oxide ($NO_x$) and/or sulphur dioxide ($SO_2$) air emissions from electric generating units (EGUs) located in Wisconsin and other states. $NO_x$ and $SO_2$ interact in the atmosphere to form ambient ozone and fine particulate matter pollution. As explained below, only the CAIR currently affects MGE's generation assets.

In 2000, the U.S. Court of Appeals for the D.C. Circuit held that Wisconsin had been illegally included in a portion of the $NO_x$ SIP Call, but stayed the remaining legal challenges to the rule pending EPA's development of additional interstate transport rules. At this time, the requirements of the $NO_x$ SIP Call and the costs of compliance remain uncertain.

In 2005, EPA promulgated the CAIR imposing additional controls on $NO_x$ and $SO_2$ emissions from EGUs located in Wisconsin and other states. However, 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 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 replacement rule. The EPA has petitioned the U.S. Court of Appeals for the D.C. Circuit to reconsider its decision *en banc*. At this time, the CAIR remains currently effective.

Our evaluation of the CAIR demonstrates that MGE will be in compliance with the CAIR's Phase I requirements without capital expenditures or modifications to our operations. We have also evaluated our potential expenditures if the CAIR remains in place for the Phase II reductions. New $SO_2$ controls at Columbia are already underway and are planned to be completed by mid to late 2014 (see the discussion regarding the Columbia Environmental Project below). Once the new environmental control project is completed at Columbia, it is expected that the plant will emit below anticipated Phase II CAIR allocation levels. MGE expects that any costs incurred to meet Phase II of the CAIR will be fully recoverable through rates.

See Footnote 8.a for additional discussion regarding CSAPR and the CAIR.

**Other Matters**

***PJM Resettlement***

MGE is a member of PJM. PJM, an RTO, is a neutral and independent party that coordinates and directs the operation of the transmission grid within its area of coverage, administers a competitive wholesale electricity market and plans regional transmission expansion improvements to maintain grid reliability and relieve congestion. In 2009, PJM determined certain market participants, including MGE, were not eligible to receive transmission loss credits. In September 2009, MGE paid PJM $1.2 million at that time as part of this resettlement.

In July 2011, FERC reversed the 2009 decision and determined PJM should refund certain amounts back to market participants, including MGE. In May 2012, FERC denied rehearing requests by financial marketers and ordered the resettlement. In July 2012, MGE received a $1.2 million refund from PJM related to the resettlement, which was credited to purchased power.

There continues to be an open rehearing request at FERC and a petition at the U.S. Court of Appeals. There is potential that MGE would have to pay back the refund received from PJM.

***Ratification of Union Agreements***

MGE has employees who are covered by a collective bargaining agreement with Local Union 2304 of the International Brotherhood of Electric Workers and also has employees who are covered by a collective bargaining agreement with Local Union No. 39 of the Office and Professional Employees International Union. Both of these collective bargaining agreements expired on April 30, 2012. On May 31, 2012, both unions ratified their respective labor agreements, which will be in effect from May 1, 2012, until April 30, 2015.

**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 PSCW approved new fuel rules that became effective January 1, 2011. The new 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 rate proceeding. 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 fuel rules costs fall outside the lower end of the range and would defer costs, less any excess revenues, if the actual 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 2012, fuel and purchased power costs included in MGE's base fuel rates are $100.7 million. See Footnote 10.b. for additional information.

MGE's gas segment is governed by the purchased gas adjustment clause (PGA). Under the PGA, MGE is able to pass through to 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 September 30, 2012, the fair value of these instruments exceeded their cost basis by $1.8 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 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 balance sheet. The fair value of the contract at September 30, 2012, reflects a loss position of $77.1 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 September 30, 2012, 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, 2011, no one customer constituted more than 9% 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 third quarter of 2012, 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 September 30, 2012, 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 September 30, 2012, 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.d. for more information.

### Item 1A. Risk Factors.

There were no material changes in the risk factors previously disclosed in Part I, Item 1A. of the 2011 Form 10-K, except as described below.

***We face construction risk in connection with the completion of the Columbia environmental project.***

The large-scale environmental project at the Columbia generating facility is subject to various risks that could cause costs to increase or delays in completion. These risks include shortages of, the inability to obtain, the cost of, and the consistency of, labor, materials and equipment; the inability of the general contractor or subcontractors to perform under their contracts; the inability to agree to terms of contracts or disputes in contract terms; work stoppages; adverse weather conditions; the inability to obtain necessary permits in a timely manner; changes in applicable laws or regulations; adverse interpretation or enforcement of permit conditions; governmental actions; legal action; and unforeseen engineering or technology issues. If the construction project is over budget, we may not be able to recover those excess costs. Inability to recover excess costs, or inability to complete the project in a timely manner, could adversely impact our financial condition and results of operations.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

**Issuer Purchases of Equity Securities**

| Period | Total Number of Shares Purchased | | Average Price Paid per Share | 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* |
|---|---|---|---|---|---|
| July 1-31, 2012 | 31,350 | $ | 48.19 | - | - |
| August 1-31, 2012 | 23,315 | | 49.50 | - | - |
| September 1-30, 2012 | 70,648 | | 52.37 | - | - |
| Total | 125,313 | $ | 50.80 | - | - |

** 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.

12 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 September 30, 2012, 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

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 September 30, 2012, 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

101 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 |

## 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: November 6, 2012 /s/ Gary J. Wolter

Gary J. Wolter
Chairman, President and Chief Executive Officer
(Duly Authorized Officer)

Date: November 6, 2012 /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: November 6, 2012

/s/ Gary J. Wolter
Gary J. Wolter
Chairman, President and Chief Executive Officer
(Duly Authorized Officer)

Date: November 6, 2012

/s/ Jeffrey C. Newman
Jeffrey C. Newman
Vice President, Chief Financial Officer, Secretary and Treasurer
(Chief Financial and Accounting Officer)