

2016 ANNUAL REPORT



# Partnerships





# 2016 annual report

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## MGE Energy, Inc.

MGE Energy is an investor-owned public utility holding company headquartered in the state capital of Madison, Wis. MGE Energy is the parent company of Madison Gas and Electric Co. The utility provides natural gas and electric service in south-central and western Wisconsin. Assets total approximately \$1.8 billion. In 2016, revenue was approximately \$545 million. See the Corporate Profile on the inside back cover.

# Partnerships



## About the cover

Partnering with our customers and communities is key to how we move forward. New opportunities, technologies and investments are opening the doors to a more sustainable future. It's the power of working together.

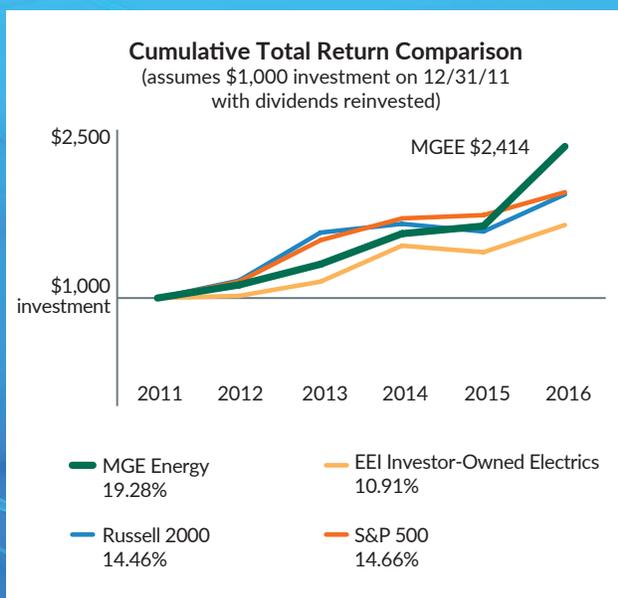
## MGE Energy (MGEE)

### Year at a Glance

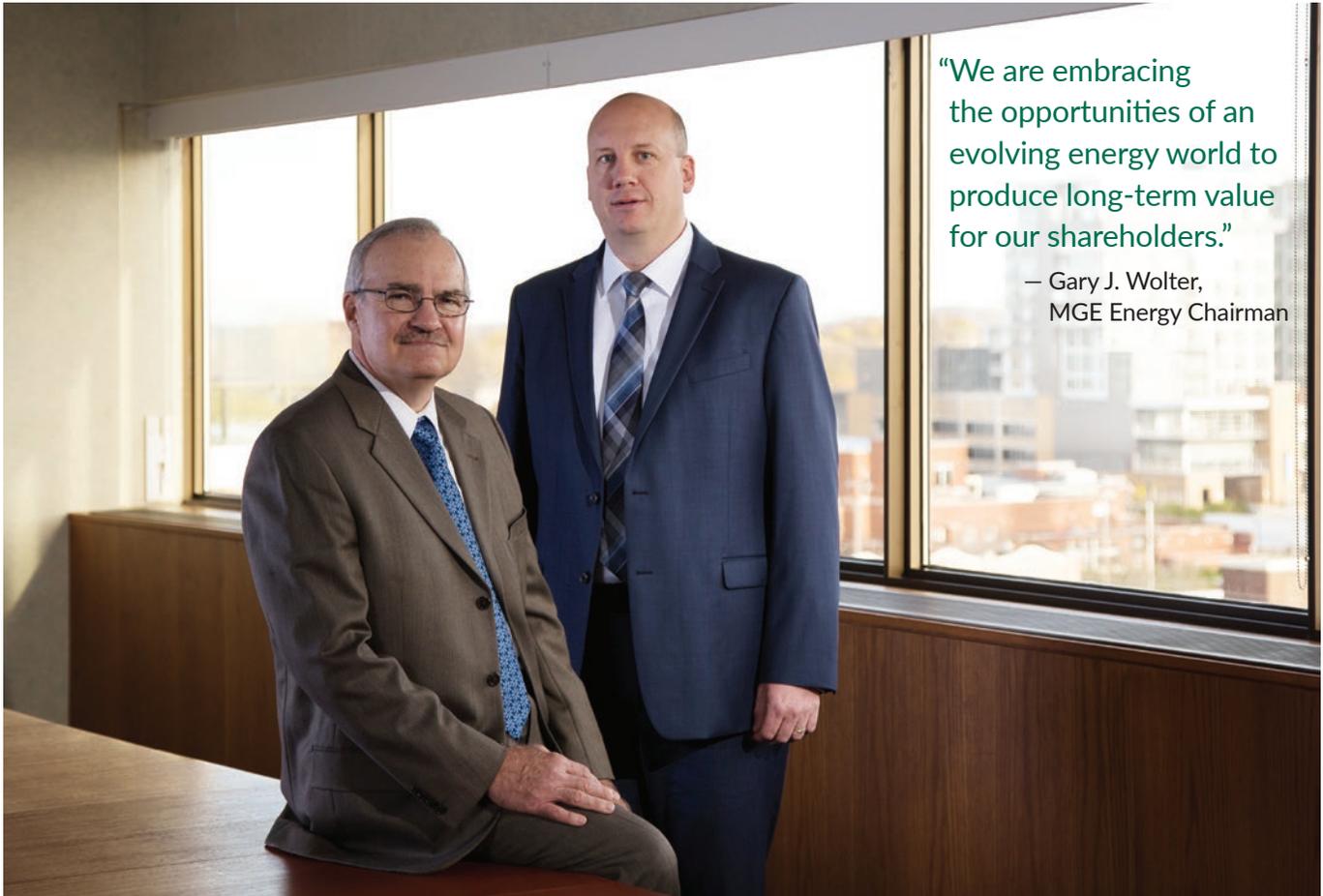
(Thousands, except per share amounts and shares outstanding)

	2016	2015	Increase/(Decrease)	% Change
Total Market Value (Dec. 31)	\$ 2,263,845	\$ 1,608,612	\$ 655,232	40.7
Market Price Per Share (Dec. 31)	\$ 65.30	\$ 46.40	\$ 18.90	40.7
Book Value Per Share	\$ 20.89	\$ 19.92	\$ 0.97	4.9
Average Shares Outstanding	34,668,370	34,668,370	-	0.0
Shares Outstanding at Year-End	34,668,370	34,668,370	-	0.0
Operating Revenues	\$ 544,745	\$ 564,028	\$ (19,283)	-3.4
Net Income	\$ 75,560	\$ 71,343	\$ 4,217	5.9
Basic and Diluted Earnings Per Share	\$ 2.18	\$ 2.06	\$ 0.12	5.8
Dividends Declared Per Share	\$ 1.21	\$ 1.16	\$ 0.05	4.3
Dividend Payout Ratio	55.5%	56.3%	(0.8)%	-1.4
Total Assets	\$ 1,801,060	\$ 1,726,403	\$ 74,657	4.3
Total Retail Electric Sales (kWh)	3,323,438	3,288,623	34,815	1.1
Total Gas Deliveries (therms)	251,354	257,031	(5,677)	-2.2

For detailed financial information, see the 2016 MGE Energy Form 10-K.



# To our shareholders



“We are embracing the opportunities of an evolving energy world to produce long-term value for our shareholders.”

— Gary J. Wolter,  
MGE Energy Chairman

Gary J. Wolter, MGE Energy Chairman, with new MGE President and CEO, Jeffrey M. Keebler

## We are partnering to create a stronger tomorrow.

Madison Gas and Electric (MGE) partners with our customers and our communities to provide critical services, to create more sustainable communities and to foster a vibrant local economy. These partnerships will continue to guide our commitment to reliability, sustainability and shareholder value.

We are proud to be a local company for more than 150 years. MGE is building upon its rich history as a community and industry leader to succeed in a rapidly changing energy world. By working together, we can accomplish our goals.

## Consistent financial performance

Building shareholder loyalty is part of our mission. In 2016, MGE Energy continued to deliver solid financial performance for our shareholders in both stock price appreciation and dividend increases.

MGE Energy is among a select group of U.S. companies dedicated to investor dividends. Compared to combination utility holding companies nationwide, MGE Energy is one of only four to increase its dividend for 41 or more consecutive years. No other Wisconsin utility or utility holding company can match our history of dividend increases.

Your Board of Directors increased the dividend by 4.2% to \$1.21 paid per share in 2016. The financial publisher Mergerstat consistently ranks us as a “Dividend Achiever” for our annual dividend increases.

MGE Energy shareholders also saw an increase in the stock price in 2016—building on a long-term trend. In the last decade, our stock price has more than doubled, outperforming both the Dow Jones Industrial Average and the S&P 500.

### Strong total return

Stock price appreciation is one part of shareholders' total return, which combines both stock price and reinvested dividends. Many shareholders choose to reinvest their dividends to grow their investment.

Taking a five-year view of our annual total return, a \$1,000 investment at the end of 2011 grew to \$2,414 by the close of 2016 with reinvested dividends.

### Earnings

In 2016, we reported earnings of \$2.18 per share, compared to \$2.06 per share in 2015, resulting from increased electric consumption due to a warmer summer in 2016 versus 2015 and due to an increase in the number of electric and gas residential customers.

### Capital expenditures

Our investments have been driven by our high standards for energy reliability, by new technologies and by our goals for a more sustainable energy future. Under our long-range Energy 2030 framework, we project an increase in our capital expenditures.

These projected investments include emission control technologies, electric distribution and metering expenditures and continued customer additions in MGE's gas service area. We also anticipate increased expenditures on renewable energy resources and natural gas generation.

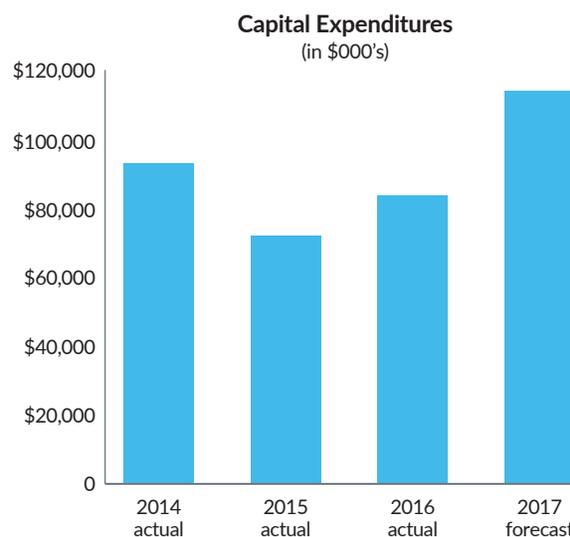
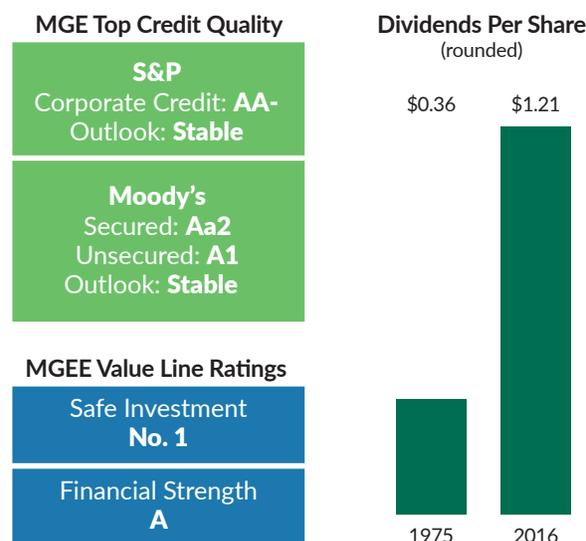
In addition, we expect to invest a significant amount of capital in information technology infrastructure for a more dynamic, integrated electric grid. Also, investments in a new customer information system, smart meters and other systems will help enhance the grid and provide customers more information about their energy use.

### National recognition

MGE Energy continues to earn recognition nationwide for its prudent approach to financial management. MGE, the main regulated subsidiary of MGE Energy, maintains the highest credit rating of any combination utility in the nation from both Standard and Poor's (S&P) and Moody's.

Value Line, Inc., also gives MGE Energy top ratings for financial strength and investment safety. We have maintained these top ratings for more than a decade.

National recognition from these leading organizations reflects our commitment to our shareholders and to strategic investments for MGE's long-term growth.



# To our shareholders

## Energy 2030: partnering for our future

Through unparalleled engagement with our customers, communities, other stakeholders and industry experts, MGE is advancing Energy 2030, our ambitious framework for our future. Energy 2030 continues our long-term direction of reducing carbon emissions, greater use of renewables, innovative products and services and ongoing partnerships.

By listening to and working with our customers, we are developing programs, products and services responsive to their needs. As we invest in new technologies, we also are building shareholder value in a changing energy world.

Our Energy 2030 framework includes two high-level goals:

- To transition toward supplying 30% of retail electric sales with renewable resources by 2030; and, 25% of retail electric sales with renewable resources by 2025.
- To work with customers to reduce carbon dioxide emissions by 40% from 2005 levels by 2030.

In 2016, as part of our ongoing commitment to invest further in cleaner energy, MGE reached an agreement to reduce our ownership in the Columbia Energy Center near Portage, Wis. MGE is a minority owner in the coal-fired power plant. Once finalized, this agreement reduces MGE's capacity from Columbia by about 33 megawatts (MW).

## Renewable energy investments

Under Energy 2030, we also are building on our history of renewable energy investments.

- MGE is proposing to construct, own and operate its largest wind farm to date. MGE began site selection in 2015 for this 66-MW wind farm about 200 miles west of Madison near Saratoga, Iowa. MGE secured the rights to the construction-ready site in 2016 from the site's initial developer. The site is well situated due to its strong winds and proximity to transmission infrastructure. In February 2017, MGE filed with state regulators its intent to seek approval to build the wind farm. If it receives regulatory approval, construction on the approximately \$107 million project could begin in 2018.



MGE's Shared Solar installation is on top of the City of Middleton's new operations center. The roof is larger than a football field and now holds more than 1,700 photovoltaic panels that feed electricity to the grid.

- We also completed construction of MGE's Shared Solar pilot project in the City of Middleton on the roof of the Municipal Operations Center. MGE owns and maintains the 500-kilowatt (kW) solar installation, which delivers locally generated solar power to the electric grid. Our innovative model for community-sourced solar is one example of how we're partnering to grow investments in renewable energy.

## Innovation

Innovative products offer new opportunities to partner with customers. Our Smart Thermostat Demand Response pilot program for residential customers will explore the use of smart technology to manage peak power demands. With customers' consent, MGE will be able to use smart thermostats to manage the electricity use of residential air conditioners to reduce peak in the summer.

In 2016, MGE launched Charge@Home. This electric vehicle charging pilot program offers drivers a faster way to charge at their homes. MGE installs and maintains the chargers. Customers enjoy faster, more convenient charging that can be controlled remotely with a smartphone. Such opportunities to work together with customers allow MGE to research new technologies while learning more about how electric vehicle charging impacts the grid.

## Sustainability

MGE partners to help create healthier communities for generations to come. As part of our partnership with the City of Middleton to build the Shared Solar project, MGE also installed a 100-kW solar array on the roof of the city's police department. The electricity from this array helps to fulfill the city's sustainability goal of 25% renewable energy by 2025.

In addition, MGE is collaborating with the City of Madison, which also has sustainability goals. MGE and the city continue to discuss how to move forward areas of mutual interest, including solar, electric vehicles and efficiency.

MGE's commitment to sustainable practices extends throughout our daily operations. For the third consecutive year, MGE has received the Green Master designation from the Wisconsin Sustainable Business Council. The statewide program evaluates applicants on their sustainable practices and results in nine operational areas to be considered for the designation. The top 20% of the companies achieve the highest-ranking category as a Green Master.

## Reliability

Our obligation to provide safe, reliable energy remains a top priority. We invest in new technologies, in infrastructure and in our people to ensure that MGE is an industry leader in electric service reliability. In 2015, we were ranked



MGE continues to expand its gas service into more rural zones bordering the growing Madison area.

number one in a nationwide industry survey for the fewest number of outages. In this yearly survey of more than 90 electric utilities, MGE has ranked in the top four utilities in the country for both the fewest number of outages and the shortest duration of outages in each of the last nine years.

MGE also scores at the top when called upon to respond to natural gas leaks. Our crews recorded the second-fastest average response times, according to a 2015 nationwide survey of more than 80 utilities. MGE averaged a response time of 16 minutes compared to a national average of 26 minutes.

We continue to expand our natural gas service to more customers through our gas expansion model, or GEM, program. Since the program's pilot in 2012, MGE has completed 14 GEM projects totaling 182 miles of gas main with additional projects planned for 2017. Through our GEM program, we're able to work with new customers and grow our investment in safe, dependable natural gas service.

## Continuity for the future

On March 1, 2017, Jeffrey Keebler succeeded Gary Wolter as President and CEO. Gary continues to serve the company as Chairman. Jeff also has been appointed to our Board of Directors. Since joining MGE in 1995, Jeff has served in various executive positions including Energy Supply and Planning, Customer Services, Information Technology and Human Resources. All of our talented employees will continue to serve with vision, ingenuity and a commitment to being a strong community energy company, building both customer and shareholder value.

We wish to thank our employees, our customers and you, our shareholders, for your contributions to our success. With deep pride and gratitude, we look forward to the future of MGE Energy.

Gary J. Wolter  
Chairman

Jeffrey M. Keebler  
President and  
Chief Executive Officer

# Partnering for sustainability

A more sustainable future is at the heart of our Energy 2030 framework, which sets goals for increasing investments in renewable energy and for reducing carbon emissions by 40% from 2005 levels by 2030. Working with customers and stakeholders, we can reach those goals. MGE is offering innovative programs and services, encouraging energy efficiency and taking advantage of new technologies. In a changing energy world, we are finding ways to add value for our stakeholders—investors, customers and communities.

## Partnerships lead to new, large solar installation

MGE owns and operates a new 1,728-panel solar installation built with community support and collaboration. Our Shared Solar project is on the roof of the City of Middleton's new operations center. Customers have signed up to purchase this clean energy through an innovative new program for community solar. Working together, we are increasing our investment in renewable resources as we advance Energy 2030 and give customers new options to support clean energy.



MOVING  
FORWARD  
TOGETHER FOR  
A CLEANER, MORE  
SUSTAINABLE  
FUTURE

Partnering with Middleton made our Shared Solar project a reality. Meeting during the solar construction on top of the Middleton Operations Center are (left to right) MGE Assistant Vice President Don Peterson, MGE Finance Director Scott Schmitt, Middleton Director of Community Development Abby Attoun and Middleton City Administrator Mike Davis.

## New wind farm proposal advances renewable energy goals

MGE is proposing to construct, own and operate a new 66-megawatt wind farm. This opportunity continues the progress the company has made in reducing carbon emissions and increasing renewable energy. The project represents a long-term, cost-effective strategy for MGE to meet its Energy 2030 commitments to cleaner energy.

MGE secured the rights to the construction-ready site in 2016 from the site's initial developer. In February 2017, MGE filed with state regulators its intent to seek approval to build the wind farm. With regulatory approval, construction could begin in 2018.

The project's 33 wind turbines would stand nearly 500 feet tall. Wind turbine technology has improved with larger turbines producing energy more efficiently.

The Saratoga project builds upon MGE's history of reducing carbon emissions and growing renewable resources. Under our now completed Energy 2015 framework, MGE increased energy from renewable resources by almost 12 times and reduced carbon emissions 20% between 2005 and 2015.



The Saratoga wind project is located in northern Iowa, about 45 miles east of MGE's Top of Iowa 3 wind farm (pictured above). The site is well situated due to its strong winds and access to transmission infrastructure. This project would be MGE's largest wind farm to date.

## Innovative efficiency program serves local businesses

Working with customers to be more energy efficient is key to meeting our Energy 2030 goals.

We are partnering with Wisconsin's Focus on Energy in a pilot program called On Demand Savings. This program encourages businesses to better manage their energy use when electric use peaks across the region. As part of the program, MGE electric meters interface with customers' own energy management systems—providing businesses real-time data on their energy use. This allows the businesses that participate in On Demand Savings to take action and control their energy use during high demand periods and helps control costs for all customers in the long run.

MGE is tracking the program's results as part of its partnership with Focus on Energy and the National Governors Association. Results from this pilot will be shared with the Governors Association, and similar programs could be replicated across the country.



At Spectrum Brands, Facility Engineering Manager Bill Wheeler (left) talks to MGE's Senior Account Representative Chris Favia about our On Demand Savings pilot program. Spectrum Brands effectively used the program to further reduce summertime energy demand in its energy-efficient headquarters.

# Partnering for a dynamic, integrated grid

A dynamic, integrated grid accommodates two-way electric flow from various power sources, such as customer-owned solar and biogas installations along with traditional power plants. MGE is building an advanced grid that can integrate new technologies while maintaining our national leadership in electric reliability.

## No. 1 in electric reliability in national survey

MGE once again has been recognized as the most reliable electric utility in the United States based on the results of a national industry survey. In 2016, MGE was ranked number one in reliability with the fewest power interruptions based on average customer outages in 2015. This reliability is core to our service and is the foundation on which we are building a utility grid for the future.

### MGE's reliability ratings

**1**   
Rated No. 1  
in the nation with  
fewest number  
of outages

**2**   
Rated No. 2  
in the nation with  
shortest outage  
duration

IMPROVING OUR  
GRID AND SERVICE  
TO MEET FUTURE  
NEEDS



We invested in a state-of-the-art distribution management system to help us operate, maintain and optimize the function of the electric grid. MGE's Distribution Systems Operations Supervisor Ross Hewitt monitors the grid in our operations center.

## Connecting new energy sources to the grid

A more advanced electric grid can handle the growth of distributed electric generation, such as customer-owned solar arrays. MGE works with customers who need help in determining how to move forward with solar and also need the reliability of grid-connected service.

Steep & Brew Coffee is a local business with nationwide coffee distribution. MGE worked with Steep & Brew to connect its 315-panel solar array to our electric grid.

MGE specialists helped to evaluate the electricity usage at the facility and provided insight into customer-owned generation. This thriving coffee business uses the electricity generated by the solar panels but still needs additional energy from MGE. On days when the panels generate excess electricity, MGE purchases the excess power and feeds it into the grid to help serve all customers.

Projects like these support our Energy 2030 objective to create a more advanced grid that supports and enables new technologies.



Mark Ballering, owner and founder of Steep & Brew Coffee, installed an 80-kilowatt photovoltaic system atop the roof of his office, roasting facility and distribution center.

## Ensuring energy reliability for a growing economy

MGE plans ahead to meet growing customer needs. A building boom in a former factory district along Madison's East Washington Avenue is a prime example. Overall, more than \$350 million in redevelopment is projected by 2020. In addition to high-rise apartments, a new \$60 million redevelopment project includes a center for entrepreneurs, office and commercial space and a 2,500-seat music venue.

MGE is extending its underground electric network system to accommodate this significant, future growth. Underground electric network systems are more reliable by design. MGE's system has redundant energy feeds to help ensure dependable energy—so if one circuit is out of service, the other takes over automatically to keep the power flowing without interruption.

Careful strategic planning and our investment in robust infrastructure will provide the energy needed for today and tomorrow.



MGE crews unload a large electric transformer to help power a new high-rise development with 244 apartments. Madison's East Washington Avenue is a growing hot spot for high-end housing and commercial space.

# Partnering to innovate

MGE partners with customers and experts to harness the power of new technologies. The way we use energy is changing—from plugging in our electric vehicles to remotely setting our home thermostats. Under our Energy 2030 framework, we are introducing new innovative products and services that offer customers more control and value. Working with customers, we research new technologies to capture benefits and provide new value.

## Working together to grow the electric vehicle market

We're helping customers plug in to make a difference. MGE is working to grow the use of electric vehicles in our community. We built an extensive network of public charging stations. We also offer electric vehicle services, such as our workplace charging program for employers. In 2016, MGE partnered with Nissan and Wisconsin Clean Cities on Drive Electric—a successful promotion that offered discounted Nissan electric vehicles.



ADVANCING  
LEADING-EDGE  
TECHNOLOGY  
TO SERVE IN AN  
EVOLVING ENERGY  
WORLD

Acumium, a local software development and digital marketing company, took advantage of discounted all-electric Nissan LEAF® vehicles. Acumium employee Sara Peck, MGE's Debbie Branson and Acumium CEO Dan Costello meet at the company's headquarters. MGE also worked with Acumium to implement a workplace charging program.

### Project taps smart thermostat technology

When temperatures climb, demand for electricity goes up too. MGE is launching a Smart Thermostat Demand Response pilot program to test a new method of controlling peaks in energy demand.

During electric peaks, utilities must use their maximum capacity of electric generation, transmission facilities and distribution lines.

Our new pilot program will test using smart thermostats to manage residential air conditioners' operations to reduce the demand for electricity while maintaining comfort. Smart thermostats can be controlled remotely through communication technologies. We are recruiting approximately 500 residential customers to participate in research with us to better understand the potential for reducing electric peaks.

MGE will, with customers' permission, use their smart thermostats' communications to set parameters, send control signals and report on air conditioner responses.



Customers can save energy almost effortlessly with smart thermostats. MGE will partner with customers in a pilot program that allows us to control their smart thermostats during summer energy demand peaks.

### Solar overhead lighting offers a new green option to customers

MGE is expanding its Outdoor Overhead Lighting program to include a new solar option. Solar structures gather the energy of the sun during the day, store that energy in batteries and then illuminate parking lots and other outdoor areas at night.

Customers can choose to have MGE install and maintain solar overhead lighting structures—especially for remote areas where access to power lines may make outdoor lighting cost prohibitive. MGE prepares a customized lighting plan and provides fixtures, poles and regular maintenance for a low monthly charge.

Adding the solar option allows MGE to offer customers more choices in how they source their energy and could potentially lead to new service options. MGE has its own outdoor solar lighting projects including a bike path near the University of Wisconsin-Madison campus and a local park.



A photovoltaic panel captures the sun's energy and stores it in a battery to power the overhead light at night. MGE will offer customers the option of installing solar outdoor overhead lighting.

# Partnering for a strong community

MGE partners with nonprofits, educators, customers, students, businesses, municipalities and others to meet the needs of the areas we serve. Under Energy 2030, we commit to further deepen our community engagement.

## Helping the next generation learn in and out of the classroom

Educating the next generation is a responsibility we all share, which is why MGE partners with local schools and academic organizations on a wide range of programs. Energy efficiency is a key part of our student outreach, which includes an interactive program and energy curriculum materials. However, learning doesn't stop with the final school bell. Every day, local nonprofits work with children to learn by doing. MGE supports these efforts. For example, at Simpson Street Free Press students in grades 3 through 12 produce and publish news stories on various media platforms, participate in book clubs and write book reviews to expand their literacy competencies.

### MGE's student outreach



30+

years of providing a popular classroom safety presentation



10+

years of publishing an Earth Day classroom activity booklet

WORKING  
WITH OUR  
COMMUNITIES  
TO CREATE A  
BRIGHTER FUTURE



When the school day is over, Simpson Street Free Press begins to fill up with students who work on articles that will be published in print and online. This 25-year-old nonprofit has won dozens of awards for its curriculum and student success.

## Venture fund spurs local business growth

To help local businesses grow, MGE works with the nonprofit Madison Development Corp. MGE and other partners formed the Venture Debt Fund, which provides loans to high-tech, start-up companies with the potential of long-term success and job creation. MGE also supports growth in the local technology sector with business incubators and by partnering with business, education and government leaders.

Since it began in 2004, the Venture Debt Fund has invested in 39 companies in the Madison area. The fund allows our economy to reap the dividend of future jobs and growing companies.

TrafficCast is a prime example. This growing company monitors traffic across North America, including all cities in the U.S. Based on advanced digital traffic data, TrafficCast provides travel time forecasting, road speed monitoring and route choices. The Venture Debt Fund has provided two rounds of financing to TrafficCast as it has continued to expand its services and to create jobs.



TrafficCast's operations center monitors cities across the nation. Meeting are (left to right) Nick Kiernan, TrafficCast Executive Vice President of Sales/Business Development; John Drury, MGE's Senior Business Development Manager; and Lorrie Heinemann, President of Madison Development Corp.

## MGE Foundation partners throughout the community

From behind the scenes, the MGE Foundation helps support a variety of nonprofit organizations that help keep our community strong. In the last five years, the MGE Foundation has given more than \$4.6 million to more than 350 community organizations ranging from the Boys and Girls Club to the United Way of Dane County.

We understand the importance of being a true community partner—whether it's through financial donations or giving of our time and talent. For example, in 2016, we launched our Career Ambassador program so high school students could get hands-on learning at MGE. Outside of work, many of our employees volunteer their time with local nonprofits—ranging from chambers of commerce to Big Brothers Big Sisters. Being a good, local partner is part of our mission to serve as a community energy company.



Karla Thennes, Executive Director of Porchlight, stands in front of a new development with 16 efficiency apartments to provide people with supportive, permanent housing. The MGE Foundation donated to the capital campaign and to help Porchlight fulfill its mission to decrease the homeless population.

# Corporate leadership

## Directors of MGE Energy and MGE



**Mark D. Bugher**

Retired Director of University Research Park, University of Wisconsin-Madison  
Age 68  
MGEE Director since 2010



**Londa J. Dewey**

President of QTI Management Services, Inc., a human resources and staffing company  
Age 56  
MGEE Director since 2008



**F. Curtis Hastings**

Retired Chairman of J. H. Findorff & Son, Inc., commercial and industrial general contractors  
Age 71  
MGEE Director since 1999



**Jeffrey M. Keebler<sup>1</sup>**

President and Chief Executive Officer of MGE Energy, Inc. and Madison Gas and Electric Co.  
Age 45  
MGEE Director as of March 1, 2017



**Regina M. Millner**

Retired President of RMM Enterprises Inc. Attorney, analyst and broker  
Age 72  
MGEE Director since 1996



**John R. Nevin**

Grainger Professor and Executive Director of Grainger Center for Supply Chain Management at the School of Business, UW-Madison  
Age 73  
MGEE Director since 1998



**James L. Possin**

Certified Public Accountant and tax consultant with James L. Possin CPA, LLC. Former partner at Grant Thornton LLP  
Age 65  
MGEE Director since 2009



**Thomas R. Stolper**

Executive Vice President and a Director of ProActive Solutions USA LLC, a cleaning and sanitizing products manufacturer  
Age 68  
MGEE Director since 2008



**Gary J. Wolter<sup>1</sup>**

Chairman of MGE Energy, Inc. and Madison Gas and Electric Co.  
Age 62  
MGEE Director since 2000

1. As of March 1, 2017, Gary Wolter retired as President and CEO of MGE Energy and MGE. Jeffrey Keebler assumed the roles of President and CEO of both companies and joined the Board of Directors.

Note: Ages as of Dec. 31, 2016.

For detailed information on board members, see the MGE Energy Proxy Statement.

## Officers of MGE Energy and MGE



**Jeffrey M. Keebler<sup>1,2</sup>**

President and Chief Executive Officer  
Age 45  
Years of Service, 21



**Jeffrey C. Newman<sup>1</sup>**

Executive Vice President, Chief Financial Officer, Secretary and Treasurer  
Age 54  
Years of Service, 32



**Craig A. Fenrick**

Executive Vice President – Energy Operations  
Age 57  
Years of Service, 34



**Lynn K. Hobbie**

Executive Vice President – Marketing and Communications  
Age 58  
Years of Service, 31



**Cari Anne Renlund**

Vice President and General Counsel  
Age 43  
Years of Service, 2



**Gregory A. Bollom**

Assistant Vice President – Energy Planning  
Age 56  
Years of Service, 34



**Jared J. Bushek**

Assistant Vice President and Chief Information Officer  
Age 36  
Years of Service, 6



**Marshall Heyworth**

Assistant Vice President – Human Resources  
Age 60  
Years of Service, 3



**Tamara J. Johnson**

Assistant Vice President and Controller  
Age 52  
Years of Service, 23



**Donald D. Peterson**

Assistant Vice President – Strategic Products and Services  
Age 57  
Years of Service, 34

1. Officers of MGE Energy and MGE. All others are MGE officers.

2. As of March 1, 2017, Jeffrey Keebler (formerly Senior Vice President - Energy Supply and Planning) was promoted to President and CEO of MGE Energy and MGE. Gary Wolter retired as President and CEO of both companies and continues to serve as Chairman of the Board of Directors.

Note: Ages and years of service as of Dec. 31, 2016.

# Shareholder information

## 2017 Annual Shareholder Meeting

Tuesday, May 16, 2017  
Marriott Madison West  
1313 John Q. Hammons Drive  
Greenway Center  
Middleton, Wis.

## Stock Listing

- MGE Energy common stock trades on The Nasdaq Stock Market®
- Stock symbol: MGEE
- Listed in newspaper stock tables as MGE

## Shareholder Services

We welcome inquiries from shareholders. Please notify us promptly if:

- A stock certificate is lost or stolen.
- A dividend check or statement is not received within 10 days of the scheduled payment date.
- Your name or address changes.

## Direct Stock Purchase and Dividend Reinvestment Plan

MGE Energy's Direct Stock Purchase and Dividend Reinvestment Plan allows investors to:

- Buy common stock directly through the company.
- Reinvest dividends.
- Deposit certificates for safekeeping.

## Materials Available

More financial information is available upon request or on our website including the Direct Stock Purchase and Dividend Reinvestment Plan.

## NAIC<sup>®</sup> National Association of Investors Corp.

MGE Energy is a corporate sponsor of the NAIC, which is a nonprofit, volunteer-based group providing investment information, education and support to help create successful lifetime investors. Web address: [betterinvesting.org](http://betterinvesting.org)

## 2017 Expected Record and Dividend Payment Dates

MGEE Common Stock	
Record Dates	Payment Dates
March 1	March 15
June 1	June 15
Sept. 1	Sept. 15
Dec. 1	Dec. 15

## Contact MGE Energy Shareholder Services

Email: [investor@mgeenergy.com](mailto:investor@mgeenergy.com)  
Web Address: [mgeenergy.com](http://mgeenergy.com)  
Madison Area: (608) 252-4744  
Continental U.S.: 1-800-356-6423  
Business Hours: 8:00 a.m. to 4:30 p.m. (Central Time)  
Monday through Friday  
Mailing Address: MGE Energy Shareholder Services  
PO Box 1231, Madison WI 53701-1231  
Location: 133 S. Blair St., Madison WI 53788-0001

## Online Account Access

Registered shareholders can access their account information online. Visit MGE Energy's website to log on through the secure My Shareholder Account link.

Contact Shareholder Services for a security code to help you set up private access to your account.

Go to the home page at [mgeenergy.com](http://mgeenergy.com) and click the My Shareholder Account link.

## Eliminate Duplicate Proxy Mailings

If you receive more than one proxy mailing from MGE Energy, you can reduce the mailbox clutter.

- Registered shareholders: call or email MGE Energy
- Brokerage shareholders: contact your broker

## Sign Up For Electronic Delivery

You may choose to receive email alerts when annual meeting invitations, proxy materials, the annual report and newsletters are available on our website. Registered shareholders can sign up by visiting [mgeenergy.com/paperless](http://mgeenergy.com/paperless). If your MGEE shares are held in a brokerage account, contact your broker.

## Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP



MGE Energy Shareholder Services (left to right) Kari Foster, Ken Frassetto, Jill Olson, Jerilyn Geishirt and Joan Stuessy.

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

**FORM 10-K**

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

*For the fiscal year ended:*  
**December 31, 2016**

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	<b>MGE Energy, Inc.</b> (a Wisconsin Corporation) 133 South Blair Street Madison, Wisconsin 53788 (608) 252-7000 mgeenergy.com	39-2040501
000-1125	<b>Madison Gas and Electric Company</b> (a Wisconsin Corporation) 133 South Blair Street Madison, Wisconsin 53788 (608) 252-7000 mge.com	39-0444025

**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

	Title of Class	Name of Each Exchange on which Registered
MGE Energy, Inc. ...	Common Stock, \$1 Par Value Per Share	The Nasdaq Stock Market

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:**

	Title of Class
Madison Gas and Electric Company .....	Common Stock, \$1 Par Value Per Share

Indicate by checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

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

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

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

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 registrants were 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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

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

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

MGE Energy, Inc. ....	Yes [ ] No [X]
Madison Gas and Electric Company .....	Yes [ ] No [X]

The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of each registrant as of June 30, 2016, was as follows:

MGE Energy, Inc. ....	\$1,954,670,687
Madison Gas and Electric Company .....	\$0

The number of shares outstanding of each registrant's common stock as of February 1, 2017, were as follows:

MGE Energy, Inc. ....	34,668,370
Madison Gas and Electric Company .....	17,347,894

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of MGE Energy, Inc.'s definitive proxy statement to be filed on or before March 27, 2017, relating to its annual meeting of shareholders, are incorporated by reference into Part III of this annual report on Form 10-K.

Madison Gas and Electric Company meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K and is therefore omitting (i.) the information otherwise required by Item 601 of Regulation S-K relating to a list of subsidiaries of the registrant as permitted by General Instruction (I)(2)(b), (ii.) the information otherwise required by Item 6 relating to Selected Financial Data as permitted by General Instruction (I)(2)(a), (iii.) the information otherwise required by Item 10 relating to Directors and Executive Officers as permitted by General Instruction (I)(2)(c), (iv.) the information otherwise required by Item 11 relating to executive compensation as permitted by General Instruction (I)(2)(c), (v.) the information otherwise required by Item 12 relating to Security Ownership of Certain Beneficial Owners and Management as permitted by General Instruction (I)(2)(c), and (vi.) the information otherwise required by Item 13 relating to Certain Relationships and Related Transactions as permitted by General Instruction (I)(2)(c).

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## **Filing Format**

This combined Form 10-K 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 economic conditions, 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," "will," and other similar words generally identify forward-looking statements. Both MGE Energy and MGE caution investors that these forward-looking statements are subject to known and unknown risks and uncertainties that may cause actual results to differ materially from those projected, expressed, or implied.

The factors that could cause actual results to differ materially from the forward-looking statements made by a registrant include (a) those factors discussed in Item 1A. Risk Factors, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 8. Financial Statements and Supplementary Data, Footnote 17. Commitments and Contingencies, 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 release publicly any revision to these forward-looking statements to reflect events or circumstances after the date of this report, except as required by law.

## **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 [sec.gov](http://sec.gov), MGE Energy's website at [mgeenergy.com](http://mgeenergy.com), and MGE's website at [mge.com](http://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.

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

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

### MGE Energy and Subsidiaries:

CWDC	Central Wisconsin Development Corporation
MAGAEL	MAGAEL, LLC
MGE	Madison Gas and Electric Company
MGE 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 Services	MGE Services, LLC
MGE State Energy Services	MGE State Energy Services, LLC
MGE Transco	MGE Transco Investment, LLC
MGEE Transco	MGEE Transco, LLC
NGV Fueling Services	NGV Fueling Services, LLC

### Other Defined Terms:

AFUDC	Allowance for Funds Used During Construction
AICPA	American Institute of Certified Public Accountants
ANR	ANR Pipeline Company
ARO	Asset Retirement Obligation
ATC	American Transmission Company LLC
ATC Holdco	ATC Holdco, LLC
BART	Best Available Retrofit Technology
Blount	Blount Station
CAA	Clean Air Act
CAVR	Clean Air Visibility Rule
CCR	Coal Combustion Residual
CIAC	Contributions in Aid of Construction
CO <sub>2</sub>	Carbon Dioxide
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
COSO	Committee of Sponsoring Organizations
CPP	Clean Power Plan
CSAPR	Cross-State Air Pollution Rule
CWA	Clean Water Act
Dth	Dekatherms
EEI	Edison Electric Institute
EGUs	Electric Generating Units
ELG	Effluent Limitations Guidelines
Elm Road Units	Elm Road Generating Station
EPA	United States Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FTR	Financial Transmission Rights
GAAP	Generally Accepted Accounting Principles
GHG	Greenhouse Gas
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
ICF	Insurance Continuance Fund
IRS	Internal Revenue Service
kVA	Kilovolt Ampere
kWh	Kilowatt-hour

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MISO	Midcontinent Independent System Operator Inc. (a regional transmission organization)
MRO	Midwest Reliability Organization
MW	Megawatt
MWh	Megawatt-hour
NAAQS	National Ambient Air Quality Standards
Nasdaq	The Nasdaq Stock Market
NERC	North American Electric Reliability Corporation
NNG	Northern Natural Gas Company
NO <sub>2</sub>	Nitrogen Dioxide
NOV	Notice of Violation
NO <sub>x</sub>	Nitrogen Oxides
NYSE	New York Stock Exchange
PCBs	Polychlorinated Biphenyls
PGA	Purchased Gas Adjustment clause
PJM	PJM Interconnection, LLC (a regional transmission organization)
PM	Particulate Matter
PPA	Purchased power agreement
ppb	Parts Per Billion
PSCW	Public Service Commission of Wisconsin
REC	Renewable Energy Credit
Riverside	Riverside Energy Center in Beloit, Wisconsin
ROE	Return on Equity
RTO	Regional Transmission Organization
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SIP	State Implementation Plan
SO <sub>2</sub>	Sulfur Dioxide
the State	State of Wisconsin
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
WEPCO	Wisconsin Electric Power Company
Working capital	Current assets less current liabilities
WPDES	Wisconsin Pollutant Discharge Elimination System
WPL	Wisconsin Power and Light Company
WPSC	Wisconsin Public Service Corporation
WRERA	Worker, Retiree and Employer Recovery Act of 2008
XBRL	eXtensible Business Reporting Language

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## PART I.

### Item 1. Business.

MGE Energy operates in the following business segments:

- Regulated electric utility operations – generating, purchasing, and distributing electricity through MGE.
- Regulated gas utility operations – purchasing and distributing natural gas through MGE.
- Nonregulated energy operations – owning and leasing electric generating capacity that assists MGE through MGE Energy's wholly owned subsidiaries MGE Power Elm Road and MGE Power West Campus.
- Transmission investments – representing our investment in American Transmission Company LLC, a company engaged in the business of providing electric transmission services primarily in Wisconsin, and our investment in ATC Holdco, a company created to facilitate out-of-state electric transmission development and investments.
- All other – investing in companies and property that relate to the regulated operations and financing the regulated operations, through its wholly owned subsidiaries CWDC, MAGAEL, MGE State Energy Services, NGV Fueling Services, and Corporate functions.

MGE's utility operations represent a majority of the assets, liabilities, revenues, expenses, and operations of MGE Energy. MGE Energy's nonregulated energy operations currently include an undivided interest in two coal-fired generating units located in Oak Creek, Wisconsin, which we refer to as the Elm Road Units, and an undivided interest in a cogeneration facility located on the Madison campus of the University of Wisconsin, which we refer to as the West Campus Cogeneration Facility or WCCF.

As a public utility, MGE is subject to regulation by the PSCW and the FERC. The PSCW has authority to regulate most aspects of MGE's business including rates, accounts, issuance of securities, and plant siting. The PSCW also has authority over certain aspects of MGE Energy as a holding company of a public utility. FERC has jurisdiction, under the Federal Power Act, over certain accounting practices and certain other aspects of MGE's business.

MGE Energy's subsidiaries are also subject to regulation under local, state, and federal laws regarding air and water quality and solid waste disposal. See "Environmental" below.

MGE Energy was organized as a Wisconsin corporation in 2001. MGE was organized as a Wisconsin corporation in 1896. Their principal offices are located at 133 South Blair Street, Madison, Wisconsin 53788, and their telephone number is (608) 252-7000.

#### Electric Utility Operations

MGE distributes electricity in a service area covering a 316 square-mile area of Dane County, Wisconsin. The service area includes the city of Madison, Wisconsin. It owns or leases ownership interests in electric generation facilities located in Wisconsin and Iowa.

At December 31, 2016, MGE supplied electric service to approximately 149,000 customers, with approximately 90% located in the cities of Fitchburg, Madison, Middleton, and Monona and 10% in adjacent areas. Of the total number of customers, approximately 87% were residential and 13% were commercial or industrial. Electric retail revenues for 2016, 2015, and 2014 were comprised of the following:

	Year Ended December 31,		
	2016	2015	2014
Residential .....	33.9%	32.6%	33.3%
Commercial.....	52.9%	53.2%	52.8%
Industrial.....	4.4%	4.8%	4.8%
Public authorities (including the UW) .....	8.8%	9.4%	9.1%
Total.....	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Electric operations accounted for approximately 75.2%, 74.2%, and 64.0% of MGE's total 2016, 2015, and 2014 regulated revenues, respectively.

See Item 2. Properties, for a description of MGE's electric utility plant.

MGE is registered with North American Electric Reliability Corporation (NERC) and one regional entity, the Midwest Reliability Organization (MRO). The essential purposes of these entities are the development and implementation of regional and NERC reliability standards; and determining compliance with those standards, including enforcement mechanisms.

### ***Transmission***

American Transmission Company LLC (ATC) was formed by utilities who were required by Wisconsin law to contribute their transmission facilities to it in 2001, and is owned by those utilities and their affiliates. ATC's purpose is to provide reliable, economic transmission service to all customers in a fair and equitable manner. ATC plans, constructs, operates, maintains, and expands transmission facilities that it owns to provide adequate and reliable transmission of power. ATC is regulated by FERC for all rate terms and conditions of service, is regulated by the PSCW as to some aspects of its governance and is a transmission-owning member of the MISO.

### ***Regional Transmission Organizations (RTO)***

#### ***MISO***

MGE is a nontransmission owning member of the MISO. MISO, a FERC approved RTO, is responsible for monitoring the electric transmission system that delivers power from generating plants to wholesale power transmitters. MISO's role is to ensure equal access to the transmission system and to maintain or improve electric system reliability in the Midwest.

MISO maintains a bid-based energy market. MGE offers substantially all of its generation on the MISO market and purchases much of its load requirement from the MISO market in accordance with the MISO Tariff. MGE participates in the ancillary services market operated by MISO. That market is an extension of the existing energy market in which MISO assumes the responsibility of maintaining sufficient generation reserves. In the ancillary services market, MISO provides the reserves for MGE's load, and MGE may offer to sell reserves from its generating units.

MGE participates in the voluntary capacity auction, which provides an optional monthly forum for buyers and sellers of aggregate planning resource credits to interact. Load serving entities, such as MGE, may participate in the voluntary capacity auction potentially to obtain the necessary aggregate planning resource credits needed to meet their planning reserve margin requirement established by the PSCW. Generator owners may participate to sell any excess aggregate planning resource credits that are not needed by them.

#### ***PJM***

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.

### ***Fuel supply and generation***

MGE satisfies its customers' electric demand with internal generation and purchased power. Sources used depend on market prices, generating unit availability, weather, and customer demand. During 2016, 2015, and 2014, MGE's electric energy delivery requirements were satisfied from the following fuel sources:

	Year Ended December 31,		
	2016	2015	2014
Coal .....	48.2%	47.9%	47.8%
Natural gas <sup>(a)</sup> .....	18.6%	9.1%	3.2%
Fuel oil .....	0.1%	0.1%	0.1%
Renewable sources .....	2.8%	3.0%	3.1%
Purchased power			
Renewable .....	8.0%	8.2%	8.7%
Other .....	22.3%	31.7%	37.1%
Total .....	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

- (a) MGE's electric operations burn natural gas in several of its peaking power plants. The market price of natural gas decreased in 2016, which improved the economics of natural gas-fueled generation over other types of generation.

### Generation Sources

MGE receives electric generation supply from coal-fired, gas-fired, and renewable energy sources. These sources include owned facilities as well as facilities leased from affiliates and accounted for under our nonregulated energy operations. See Item 2. Properties for more information regarding these generation sources, including location, capacity, ownership or lease arrangement, and fuel source. See "Nonregulated Energy Operations" below for more information regarding generating capacity leased to MGE by nonregulated subsidiaries.

### Purchased power

MGE enters into short and long-term purchase power commitments with third parties to meet a portion of its anticipated electric energy supply needs. The following table identifies purchase power commitments at December 31, 2016, with unaffiliated parties for the next five years.

(Megawatts)	2017	2018	2019	2020	2021
Purchase power commitments.....	152.5	102.5	98.5	98.5	98.5

### Gas Utility Operations

MGE transports and distributes natural gas in a service area covering 1,682 square miles in seven south-central Wisconsin counties. The service area includes the city of Madison, Wisconsin and surrounding areas.

At December 31, 2016, MGE supplied natural gas service to approximately 154,000 customers in the cities of Elroy, Fitchburg, Lodi, Madison, Middleton, Monona, Prairie du Chien, Verona, and Viroqua; 25 villages; and all or parts of 48 townships. Of the total number of customers, approximately 90% were residential and 10% were commercial or industrial. Gas revenues for 2016, 2015, and 2014 were comprised of the following:

	Year Ended December 31,		
	2016	2015	2014
Residential .....	60.2%	59.4%	53.0%
Commercial.....	34.9%	35.7%	34.3%
Industrial <sup>(a)</sup> .....	1.1%	1.3%	11.0%
Transportation service and other <sup>(a)</sup> .....	3.8%	3.6%	1.7%
Total.....	100.0%	100.0%	100.0%

- (a) During 2015, a large interruptible industrial customer decided to purchase gas from a third party supplier to use MGE's facilities for the transport of that gas, resulting in a shift in gas revenues between industrial and transportation services.

Gas operations accounted for approximately 24.8%, 25.8%, and 36.0% of MGE's total 2016, 2015, and 2014 regulated revenues, respectively.

MGE can curtail gas deliveries to its interruptible customers. Approximately 3% of retail gas deliveries in 2016 and 2015 were to interruptible customers.

### Gas supply

MGE has physical interconnections with ANR Pipeline Company (ANR) and Northern Natural Gas Company (NNG). MGE's primary service territory, which includes Madison and the surrounding area, receives deliveries at one NNG and four ANR gate stations. MGE's outlying territory receives deliveries at NNG gate stations located in Elroy, Prairie du Chien, Viroqua, and Crawford County. Interconnections with two major pipelines provide competition in interstate pipeline service and a more reliable and economical gas supply mix, which includes gas from Canada and from the mid-continent and Gulf/offshore regions in the United States.

During the winter months, when customer demand is high, MGE is primarily concerned with meeting its obligation to firm customers. MGE meets customer demand by using firm supplies under contracts finalized before the heating season, supplies in storage (injected during the summer), and other firm supplies purchased during the winter period.

By contract, a total of 5,936,318 Dth of gas can be injected into ANR's storage fields in Michigan from April 1 through October 31. These gas supplies are then available for withdrawal during the subsequent heating season, November 1 through March 31. Using storage allows MGE to buy gas supplies during the summer season, when prices are normally lower, and withdraw these supplies during the winter season, when prices are typically higher. Storage also gives MGE more flexibility in meeting daily load fluctuations.

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MGE's contracts for firm transportation service of gas include winter maximum daily quantities of:

- 162,150 Dth (including 106,078 Dth of storage withdrawals) on ANR.
- 65,828 Dth on NNG.

### **Nonregulated Energy Operations**

MGE Energy, through its subsidiaries, has developed generation sources that assist MGE in meeting the electricity needs of its customers. These sources consist of the Elm Road Units and the WCCF, which are leased by MGE Power Elm Road and MGE Power West Campus, respectively, to MGE. See Item 2. Properties for a description of these facilities, their joint owners, and the related lease arrangements.

### **Transmission Investments**

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 as required by Wisconsin law. That interest is presently held by MGE Transco, which is owned by MGE Energy. At December 31, 2016, MGE Transco held a 3.6% ownership interest in ATC.

In 2011, ATC and Duke Energy announced the creation of a joint venture, Duke-American Transmission Company, LLC, that seeks to build, own, and operate new electric transmission infrastructure in North America to address increasing demand for affordable, reliable transmission capacity.

In 2016, ATC Holdco was formed by several of the members of ATC, including MGE Energy, to facilitate electric transmission development and investments outside of Wisconsin. MGE Energy's ownership interest in ATC Holdco is held by MGEE Transco, a wholly-owned subsidiary. At December 31, 2016, MGEE Transco held a 4.0% ownership interest in ATC Holdco. In the near term, it is expected that ATC Holdco will be pursuing transmission development opportunities that typically have long development and investment lead times before becoming operational.

### **Environmental**

MGE Energy and MGE are subject to frequently changing local, state, and federal regulations concerning air quality, water quality, land use, threatened and endangered species, hazardous materials handling, and solid waste disposal. These regulations affect the manner in which they conduct their operations, the costs of those operations, as well as capital and operating expenditures. Regulatory initiatives, proposed rules, and court challenges to adopted rules, have the potential to have a material effect on our capital expenditures and operating costs. In addition to the regulations discussed below, MGE continues to track state and federal initiatives such as potential changes to regulations governing polychlorinated biphenyl (PCB), potential changes to air and water standards, and potential climate change legislation.

#### ***Water Quality***

##### ***EPA's Effluent Limitations Guidelines (ELG) and Standards for Steam Electric Power Generating Point Source Category***

The ELG rule establishes federal limits on the amount of metals and other pollutants that can be discharged in wastewater from new and existing steam electric generation plants. The ELG rule mostly covers pollutants that are captured by certain air pollution control systems and via wet ash handling systems at coal-burning power plants with units greater than 50 MW generation capacity. The operators of our Columbia and Elm Road Units have indicated that equipment upgrades may be necessary to comply with the new discharge standards. The rule will be applied to Wisconsin-based power plants as they renew their WPDES permits, beginning in 2018 but no later than 2023. Management believes that any compliance costs will be recovered in future rates based on previous treatment of environmental compliance projects.

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

Section 316(b) of the Clean Water Act requires that the cooling water intake structures at electric power plants meet best available technology standards so that mortality from entrainment (drawing aquatic life into a plant's cooling system) and impingement (trapping aquatic life on screens) are reduced. The Wisconsin Department of Natural Resources is currently developing guidance and rules to implement the EPA 316(b) rule.

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Both our Blount plant and our Columbia plant have WPDES permits that are up for renewal in 2017 and will need to comply with the 316(b) requirements, Blount has conducted historical studies that will show that it will likely be in compliance with this rule. The operator of our Columbia plant is conducting an intake study to demonstrate compliance and/or identify design criteria needed to meet the new rule requirements prior to Columbia's 2017 WPDES permit renewal. The exact requirements at Blount and Columbia, however, will not be known until the WDNR finalizes its rule, approves the plant operators' approach, and WPDES permits are modified to account for this rule. Nonetheless, MGE expects that the 316(b) rule will not have material effects on its existing plants.

### ***Energy Efficiency and Renewables***

The Wisconsin Energy Efficiency and Renewables Act requires that 10% of the state's electricity be generated from renewable sources. MGE is in compliance with the requirement. The costs to comply with the Act and its accompanying regulations are being recovered in rates.

### ***Air Quality***

Air quality regulations promulgated by the EPA and Wisconsin Department of Natural Resources (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<sub>2</sub>), nitrogen oxides (NO<sub>x</sub>), hazardous air pollutants and other pollutants, and require permits for operation of emission sources. These permits must be renewed periodically. Various newly enacted and/or proposed federal and state initiatives may result in additional operating and capital expenditure costs for fossil-fueled electric generating units.

#### ***Ozone NAAQS***

In October 2015, the EPA revised the primary and secondary ozone NAAQS, lowering it to 70 ppb. The final standard will likely cause Milwaukee County, where our Elm Road Units are located, to be designated as nonattainment for ozone. A nonattainment designation may have an effect on operations at our facilities, however, the NAAQS process involves many steps and any effect on our generation units will not be fully understood until the State of Wisconsin develops, receives approval for, and finalizes an implementation plan for any counties found to be in nonattainment.

The State of Wisconsin has joined a lawsuit filed by several states challenging the EPA's new ozone standard. Oral arguments in this case are scheduled to begin in April 2017. MGE will continue to monitor the EPA's progress on attainment designations and related litigation to assess potential impacts at our facilities, particularly our Elm Road Units.

#### ***Nitrogen Dioxide (NO<sub>2</sub>) NAAQS***

The WDNR has revised its state rules to incorporate the EPA's one hour NO<sub>2</sub> NAAQS rule that was finalized in 2010. The effective date of the state rule was August 1, 2016. The WDNR is currently seeking input from the public on ideas for implementing this one-hour standard. Wisconsin's NO<sub>2</sub> NAAQS rule will affect our stationary fossil-fuel generation sources by requiring that we demonstrate consistency with the NAAQS when applying for certain air permits. Sources that cannot demonstrate compliance with the NAAQS may be required to install emission controls or restrict operations. MGE will continue to monitor developments while the WDNR implements guidance for compliance with the one-hour NAAQS.

#### ***EPA's Cross-State Air Pollution Rule: Proposed Ozone Season Update based on 2008 Ozone NAAQS***

The EPA's Cross-State Air Pollution Rule (CSAPR) is an interstate air pollution transport rule designed to reduce ozone and fine particulate (PM<sub>2.5</sub>) air levels in areas that the EPA has determined are being affected by pollution from neighboring and upwind states. This is accomplished in the CSAPR through a reduction in SO<sub>2</sub> and NO<sub>x</sub> from qualifying fossil-fuel fired power plants in upwind or "contributing" states. NO<sub>x</sub> and SO<sub>2</sub> contribute to fine particulate pollution, and NO<sub>x</sub> contributes to ozone formation. Reductions are achieved through a cap and trade system. Individual plants can meet their caps through modifications and/or buying allowances on the market.

In October 2016, the EPA finalized rulemaking for an update to CSAPR that incorporated 2008 Ozone NAAQS levels into the rule (the original CSAPR is based on 1997 Ozone NAAQS levels). The update affects 22 states, including Wisconsin, by further limiting statewide NO<sub>x</sub> allowances in each of those states. The rule also includes revisions to CSAPR that are designed to address issues remaining from the D.C. Circuit remand of CSAPR, including Wisconsin's inclusion in the NO<sub>x</sub> ozone season portion of the rule. The State of Wisconsin filed a legal challenge to the CSAPR update rule asserting, among other things, that the rule over-controls NO<sub>x</sub> emissions in Wisconsin.

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The CSAPR Update rule will further reduce summertime (or Ozone Season) NO<sub>x</sub> emissions allocations from power plants starting in 2017. MGE intends to meet the rule requirements through a combination of allocations owned, received, or purchased. Depending on the number of allocations MGE receives for ozone season, the number of allocations that MGE must purchase, and the cost of allocations, this requirement could be material for MGE.

#### Clean Air Visibility Rule (CAVR)

Columbia is subject to the best available retrofit technology (BART) regulations, a subsection of the EPA's Clean Air Visibility Rule (CAVR), which may require pollution control retrofits. Columbia's existing pollution control upgrades, and the EPA's stance that compliance with the CSAPR equals compliance with BART, should mean that Columbia will not need to do additional work to meet BART requirements. At this time, however, the BART regulatory obligations, compliance strategies, and costs remain uncertain due to the continued legal challenges surrounding CSAPR and CAVR.

In December 2016, the EPA introduced a final rule (posted online but not yet scheduled for publication in the Federal Register) extending state implementation plan deadlines by three years from 2018 to 2021 for the next implementation phase of the CAVR, which goes beyond BART and may affect utilities. This extension would allow for states to coordinate their CAVR compliance with other compliance efforts, which should lessen the burden to comply. It is too early to determine if the rule will affect MGE. MGE will continue to monitor developments.

#### ***Global Climate Change***

MGE is a producer of GHG emissions, primarily from the fossil fuel generating facilities it uses 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, operational limits on our coal plants, permitting difficulties, and emission limits. MGE management would expect to seek and receive rate recovery of such compliance costs, if and when required. MGE continues to monitor proposed climate change legislation and regulation.

MGE has taken steps to address GHG emissions through voluntary actions. In 2005, MGE implemented its Energy 2015 Plan, which committed to ensuring a balanced, economic energy supply with reduced environmental emissions. The Plan emphasized increased renewable energy, energy efficiency, and new cleaner generation – three strategies that reduced GHG emissions. Under the Plan and other actions, our CO<sub>2</sub> emissions declined from 2005 to 2015 by approximately 20% even though total system energy increased. In 2015, MGE announced its Energy 2030 framework that continues steps to reduce CO<sub>2</sub> emissions. Subject to regulatory approvals and other conditions, MGE aims to increase renewable energy to 25% of retail electric sales by 2025 and to 30% by 2030. Under our Energy 2030 framework, we will also work to reduce CO<sub>2</sub> emissions by 40% from 2005 levels by 2030.

#### ***Climate Change Legislation***

It is not anticipated that U.S. Congress will enact broad GHG reduction legislation in 2017.

It is not expected that the Wisconsin Legislature will enact broad GHG regulation in 2017.

#### ***Greenhouse Gas Regulation***

##### EPA's Greenhouse Gas (GHG) Reduction Guidelines under the Clean Air Act 111d Rule

The EPA's Clean Power Plan (CPP) rule became effective in December 2015, setting guidelines for states to use in developing plans to control GHG emissions from existing fossil fuel-fired EGUs and systems. When fully implemented in 2030, the Clean Power Plan is projected to reduce GHG emissions from this sector by 32% below 2005 levels. States are given up to three years to submit a plan or be subject to a federal plan to meet the reduction goals, and states are expected to meet interim goals starting in 2022 and the final goals in 2030. Implementation of the rule is expected to have a direct impact on coal and natural gas fired generating units, including possible changes in dispatch and additional operating costs.

In October 2015, many states (including Wisconsin) and other litigants filed petitions with the U.S. Court of Appeals for the District of Columbia Circuit. On January 26, 2016, several parties filed a request for a stay of the CPP with the U.S. Supreme Court; and on February 9, 2016, the U.S. Supreme Court granted that request. The CPP may not be implemented until the courts ultimately resolve the underlying legality of the rule, which is expected in 2017.

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Given the pending legal proceedings the nature and timing of any final requirements is subject to uncertainty. If the rule remains substantially in its present form, it is expected to have a material impact on MGE.

### ***Solid Waste***

#### **EPA's Coal Combustion Residuals Rule**

In December 2014, the EPA finalized its Disposal of Coal Combustion Residuals from Electric Utilities (CCR) rule. The rule became effective in October 2015. It provides that coal ash will be regulated as a solid waste, and defines what ash use activities would be considered generally exempt beneficial reuse of coal ash. The rule also regulates landfills, ash ponds, and other surface impoundments for coal combustion residuals by regulating their design, location, monitoring, and operation. This portion of the rule is accomplished in phases to allow for sites with onsite storage and/or disposal to evaluate their compliance with the rule's design criteria. Landfills and impoundments that cannot meet design criteria will need to close formally within defined timeframes.

The Columbia and Elm Road Units co-owners and plant operators are working through the phased requirements to plan and implement changes necessary at those facilities to meet design criteria. Review of our Elm Road Units has indicated that the costs to comply with this rule are not expected to be significant. Columbia's operator has developed a preliminary implementation schedule for meeting the various deadlines spelled out in the rule. Costs at Columbia will be dependent on what is determined during the evaluation stage. Management believes compliance costs will be recovered in future rates based on previous treatment of environmental compliance projects.

### ***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 as noted below.

#### **Columbia Clean Air Act Litigation**

Columbia is a coal-fired generating station operated by WPL in which WPL, WPSC, and MGE have ownership interests. In December 2009, the EPA sent a Notice of Violation (NOV) to the co-owners, including MGE. The NOV alleged that WPL and the Columbia co-owners failed to comply with appropriate pre-construction review and permitting requirements and, as a result, violated the Prevention of Significant Deterioration program requirements, Title V Operating Permit requirements of the CAA, and the Wisconsin SIP. In June 2013, the court approved and entered a consent decree entered by the EPA, Sierra Club, and the co-owners of Columbia. One of the requirements of the consent decree requires installation of an SCR system at Columbia Unit 2 by December 31, 2018. Installation of the SCR has been approved by the PSCW and is currently under construction. MGE's share of the projected cost for the SCR system is estimated to be \$22-\$24 million, with expected completion in 2018.

### ***Employees***

As of December 31, 2016, MGE had 704 employees. MGE employs 227 employees who are covered by a collective bargaining agreement with Local Union 2304 of the International Brotherhood of Electrical Workers and 84 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 expire on April 30, 2018. There are also 5 employees covered by a collective bargaining agreement with Local Union No. 2006, Unit 6 of the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial, and Service Workers International Union. This collective bargaining agreement expires on October 31, 2018.

### ***Financial Information About Segments***

See Footnote 20 of the Notes to the Consolidated Financial Statements for financial information relating to MGE Energy's and MGE's business segments.

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## Executive Officers of the Registrants

As of December 31, 2016, the executive officers of the registrants were as follows:

Executive	Title	Effective Date	Service Years as an Officer
Gary J. Wolter <sup>(a)</sup> Age: 62	Chairman of the Board, President and Chief Executive Officer	02/01/2002	27
Jeffrey M. Keebler <sup>(b)</sup> Age: 45	Senior Vice President - Energy Supply and Planning Assistant VP - Energy Supply and Customer Service	07/23/2015 01/01/2012	5
Craig A. Fenrick <sup>(b)</sup> Age: 57	Senior Vice President - Energy Operations Vice President - Energy Delivery Vice President - Electric Transmission and Distribution	07/23/2015 02/10/2015 01/01/2012	10
Lynn K. Hobbie <sup>(b)</sup> Age: 58	Senior Vice President - Marketing and Communications	02/01/2000	22
Jeffrey C. Newman <sup>(a)</sup> Age: 54	Senior Vice President, Chief Financial Officer, Secretary and Treasurer Vice President, Chief Financial Officer, Secretary and Treasurer	07/23/2015 01/01/2009	19
Cari Anne Renlund <sup>(b)</sup> Age: 43	Vice President and General Counsel Dewitt Ross & Stevens S.C. (law firm) - Partner	11/02/2015 06/11 – 10/15	1

Note: Ages, years of service, and positions as of December 31, 2016.

(a) Executive officer of MGE Energy and MGE.

(b) Executive officer of MGE.

### Item 1A. Risk Factors.

MGE Energy and its subsidiaries, including MGE, operate in a market environment that involves significant risks, many of which are beyond their control. The following risk factors may adversely affect their results of operations, cash flows and market price for their publicly traded securities. While MGE Energy and MGE believe they have identified and discussed below the key risk factors affecting their business, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant that may adversely affect their performance or financial condition in the future.

#### Regulatory Risk

***We are subject to extensive government regulation in our business, which affects our costs and responsiveness to changing events and circumstances.***

Our business is subject to regulation at the State and Federal levels. We are subject to regulation as a holding company by the PSCW. MGE is regulated by the PSCW as to its rates, terms and conditions of service; various business practices and transactions; financing; and transactions between it and its affiliates, including MGE Energy. MGE is also subject to regulation by the FERC, which regulates certain aspects of its business. The regulations adopted by the State and Federal agencies affect the manner in which we do business, our ability to undertake specified actions since pre-approval or authorization may be required, the costs of operations, and the level of rates charged to recover such costs. Our ability to attract capital is also dependent, in part, upon our ability to obtain a fair return from the PSCW.

***We could be subject to higher costs and potential penalties resulting from mandatory reliability standards.***

MGE must adhere to mandatory reliability standards for its electric distribution system established by NERC. These standards cover areas such as critical infrastructure protection, emergency preparedness, facility design, and transmission operations, among others. The critical infrastructure protection standards focus on physical and access security of cyber assets, as well as incident response and recovery planning. MGE could be subject to higher operating costs in order to maintain compliance with the mandatory reliability standards, and any noncompliance could result in sanctions including monetary penalties.

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***We are subject to changing environmental laws and regulations that may affect our costs and business plans.***

Our subsidiaries are subject to environmental laws and regulations that affect the manner in which they conduct business, including capital expenditures, operating costs and potential liabilities. Changes and developments in these laws and regulations may alter or limit our business plans, make them more costly, or expose us to liabilities for past or current operations.

Numerous environmental laws and regulations govern many aspects of our present and future operations, including air emissions, water quality, wastewater discharges, solid waste, threatened and endangered species, and hazardous waste. These evolving regulations can introduce uncertainty with respect to capital expenditures and operational planning, and can introduce costly delays if previous decisions need to be revisited as a result of judicial mandate or regulatory change. These regulations generally require us to obtain and comply with a wide variety of environmental permits and approvals, and can result in increased capital, operating, and other costs and operating restrictions, particularly with regard to enforcement efforts focused on obligations under existing regulations with respect to power plant emissions and compliance costs associated with regulatory requirements. These effects can be seen not only with respect to new construction but could also require the installation of additional control equipment or other compliance measures such as altered operating conditions at existing facilities.

In addition, we may be a responsible party for environmental clean-up at current or future sites identified as containing hazardous materials or to which waste was sent that is subsequently determined to be hazardous. It is difficult to predict the costs potentially associated with a site clean-up due to the potential joint and several liability for all potentially responsible parties, the nature of the clean-up required, and the availability of recovery from other potentially responsible parties.

The following are significant proposed regulations that are expected to impact our operations:

The EPA's Cross-State Air Pollution Rule (CSAPR) is an interstate air pollution transport rule designed to reduce ozone and fine particulate (PM<sub>2.5</sub>) air levels in areas that the EPA has determined are being affected by pollution from neighboring and upwind states. In October 2016, the EPA finalized rulemaking for an update to CSAPR that incorporated 2008 Ozone NAAQS levels into the rule (the original CSAPR is based on 1997 Ozone NAAQS levels). The update affects 22 states, including Wisconsin, by further limiting statewide NO<sub>x</sub> allowances in each of those states. Depending on the number of allocations MGE receives for ozone season, the number of allocations that MGE must purchase, and the cost of allocations, this requirement could be material for MGE.

In October 2015, the EPA finalized its Clean Power Plan (CPP) rule with an effective date of December 2015, setting guidelines and approval criteria for states to use in developing plans to control GHG emissions from existing fossil fuel-fired electric generating units (EGUs) and systems. Implementation of the rule is expected to have a direct impact on existing coal and natural gas fired generating units, including possible changes in dispatch and additional operating costs. Given the pending legal proceedings, the nature and timing of any final requirements is subject to uncertainty. If the rule remains substantially in its present form, it is expected to have a material impact on MGE.

***We face risk for the recovery of fuel and purchased power costs.***

MGE has price risk exposure with respect to the price of natural gas, electricity, coal, emission credits, and oil. MGE burns natural gas in several of its peak electric generation facilities, and in many cases, the cost of purchased power is tied to the cost of natural gas. Under the electric fuel rules, MGE is required to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band that is currently plus or minus 2% around the amount approved in its most recent rate order. Any over/under recovery of the actual costs in a year is determined in the following year and is then reflected in future billings to electric retail customers. Under the electric fuel rules, MGE is required to defer the benefit of lower costs, if its actual fuel costs fall outside the lower end of the range, and is required to defer costs, less any excess revenues, if its actual fuel costs exceed 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. MGE assumes the risks and benefits of variances that are within the cost tolerance band.

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## Operating Risk

### *We are affected by weather, which affects customer demand and can affect the operation of our facilities.*

The demand for electricity and gas is affected by weather. Very warm and very cold temperatures, especially for prolonged periods, can dramatically increase the demand for electricity and gas for cooling and heating, respectively, as opposed to the softening effect of more moderate temperatures. Our electric revenues are sensitive to the summer cooling season and, to a lesser extent, the winter heating season. Similarly, very cold temperatures can dramatically increase the demand for gas for heating. A significant portion of our gas system demand is driven by heating. Extreme summer conditions or storms may stress electric transmission and distribution systems, resulting in increased maintenance costs and limiting the ability to meet peak customer demand.

### *We could be adversely affected by changes in the development, and utilization by our customers, of power generation, storage, and use technology.*

Our revenues and the timing of the recovery of our costs could be adversely affected by improvements in power generation, storage, and use technology.

Advancements in power generation technology, including commercial and residential solar generation installations and commercial micro turbine installations, are improving the cost-effectiveness of customer self-supply of electricity. Improvements in energy storage technology, including batteries and fuel cells, could also better position customers to meet their around-the-clock electricity requirements. Improvements in the energy efficiency of lighting, appliances, and equipment will also affect energy consumption by customers. Such developments could reduce customer purchases of electricity, but may not necessarily reduce our investment and operating requirements due to our obligation to serve customers, including those self-supply customers whose equipment has failed for any reason to provide the power they need whether due to inadequate on-site resources, restricted operating hours, or equipment failure. In addition, since a portion of our costs are recovered through charges based upon the volume of power delivered, reductions in electricity deliveries will affect the timing of our recovery of those costs and may require changes to our rate structures.

Changes in power generation, storage, and use technology could have significant effects on customer behaviors and their energy consumption. Customers could engage in individual conservation efforts by voluntarily reducing their consumption of electricity through voluntary changes in energy use and through the use of more energy efficient lighting, appliances, and equipment. They could also change their consumption of electricity from us through the installation of alternative energy sources, such as roof top solar panels and micro turbines for self-supply. Customer energy conservation could adversely affect our results of operations by reducing our revenues without necessarily changing our operating costs due to our obligation to serve.

### *We are affected by economic activity within our service area.*

Higher levels of development and business activity generally increase the numbers of customers and their use of electricity and gas. Likewise, periods of recessionary economic conditions generally adversely affect our results of operations.

### *Our ability to obtain an adequate supply of coal could limit our ability to operate our coal-fired facilities.*

The availability of coal and the means to transport coal could:

- Affect our operating costs due to increased costs associated with lower levels of generation or the need for alternate supply or alternate transportation,
- Limit our ability to generate electricity if we are unable to arrange adequate deliveries of coal, and
- Result in potentially higher costs for replacement purchased power as well as potential lost market sales opportunities.

A significant portion of our electric generating capacity is dependent on coal. Demand for coal has been impacted by prevailing prices for natural gas and may affect mine performance. Consequently, we are exposed to the risk that counterparties to these contracts will not be able to fulfill their obligations. Disruption in the delivery of fuel, including disruptions as a result of transportation delays, weather, labor relations, force majeure events, or

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environmental regulations affecting any of these fuel suppliers, could limit our ability to generate electricity at our facilities at the desired level. Should counterparties fail to perform, or other unplanned disruptions occur, we may be forced to replace the underlying commitment at higher prices, or we may be forced to reduce generation at our coal units and replace this lost generation through additional power purchases from third parties. These factors may also affect the terms under which any of our existing coal supply or transportation agreements are renewed or replaced upon the expiration of their current terms.

***Our ability to manage our purchased power costs is influenced by a number of uncontrollable factors.***

We are exposed to additional purchased power costs to the extent that our power needs cannot be fully covered by the supplies available from our existing facilities and contractual arrangements. Those needs, and our costs, could be affected by:

- Increased demand due to, for example, abnormal weather, customer growth, or customer obligations,
- The inability to transmit our contracted power from its generation source to our customers due to transmission line constraints, outages, or equipment failures,
- Reductions in the availability of power from our owned or contracted generation sources due to equipment failures, shortages of fuel or environmental limitations on operations, and
- Failure to perform on the part of any party from which we purchase capacity or energy, whether due to equipment failures or other causes.

An unexpected change in demand or the availability of generation or transmission facilities can expose us to increased costs of sourcing electricity in the short-term market where pricing may be more volatile.

***The equipment and facilities in our operational system are subject to risks which may adversely affect our financial performance.***

Weather conditions, accidents, and catastrophic events can result in damage or failures of equipment or facilities and disrupt or limit our ability to generate, transmit, transport, purchase, or distribute electricity and gas. Efforts to repair or replace equipment and facilities may take prolonged periods or may be unsuccessful, or we may be unable to make the necessary improvements to our operational system, causing service interruptions. The resulting interruption of services would result in lost revenues and additional costs. We are also exposed to the risk of accidents or other incidents that could result in damage to or destruction of our facilities or damage to persons or property. Such issues could adversely affect revenues or increase costs to repair and maintain our systems.

***Our operations and confidential information are subject to the risk of cyber-attacks.***

Our operations rely on sophisticated information technology systems and networks. Cyber-attacks targeting our electronic control systems used at our generating facilities and for electric and gas distribution systems, could result in a full or partial disruption of our operations. Any disruption of these operations could result in a loss of service to customers and loss of revenue, as well as significant expense to repair system damage and remedy security breaches.

Our business requires the collection and retention of personally identifiable information of our customers, shareholders, and employees, who expect that we will adequately protect such information. A significant theft, loss, or fraudulent use of personally identifiable information may cause our business reputation to be adversely impacted and could lead to potentially large costs to notify and protect the impacted persons. The occurrence of such an event may cause us to become subject to legal claims, fines, or penalties, any of which could adversely impact our results of operations.

The safeguards we have may not always be effective due to the evolving nature of cyber-attacks. We cannot guarantee that such protections will be completely successful in the event of a cyber-attack. If the technology systems were to fail or be breached by a cyber-attack, and not be recovered in a timely fashion, we may be unable to fulfill critical business functions and confidential data could be compromised, adversely impacting our financial condition and results of operations.

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***We rely on the performance of our information technology systems, the failure of which could have an adverse effect on our business and performance.***

We operate in a highly engineered industry that requires the continued operation of sophisticated information technology systems and network infrastructure to manage our finances, to operate our control facilities, to provide electric and gas service to our customers, and to enable compliance with applicable regulatory requirements. Our computer-based systems are vulnerable to interruption or failure due to the age of certain systems, the introduction of viruses, malware, security breaches, fire, power loss, system malfunction, network outages and other events, which may be beyond our control. System interruptions or failures, whether isolated or more widespread, could impact our ability to provide service to our customers, which could have a material adverse effect on our operations and financial performance.

***Acts of terrorism could materially and adversely impact our operations and financial condition.***

Facilities for electric generation, transmission, and gas distribution are subject to the risk of being potential targets of terrorist threats and activities. A terrorist act at our facilities could result in a disruption of our ability to generate, transmit, transport, purchase, or distribute electricity or natural gas. A possible attack would have additional adverse effects, including environmental ramifications, increased security and insurance costs, as well as general economic volatility or uncertainty within our service territories. The inability to maintain operational continuity and any additional costs incurred for repairing our facilities could materially and adversely affect our financial condition and results of operations.

***Failure to attract and retain an appropriately qualified workforce could affect our operations.***

Events such as an aging workforce and retirement of key employees without appropriate replacements may lead to operating challenges and increased costs. Some of the challenges include lack of resources, loss of knowledge, and length of time period associated with skill development. Failure to identify qualified replacement employees could result in decreased productivity and increased safety costs. If we are unable to attract and retain an appropriately qualified workforce, our operations could be negatively affected.

## **Financial Risk**

***We are exposed to commodity price risk relating to our purchases of natural gas, electricity, coal and oil.***

We face commodity price risk exposure with respect to our purchases of natural gas, electricity, coal, oil, and environmental allowances and risk through our use of derivatives, such as futures, forwards and swaps, to manage that commodity price risk. We could experience increased costs as a result of volatility in the market values of those commodities. We could also experience losses on our derivative contracts as a result of that market value volatility or if a counterparty fails to perform under a contract. In the absence of actively quoted market prices and pricing information from external sources, the valuation of these derivative contracts involves our exercise of judgment and use of estimates. As a result, changes in the underlying assumptions or use of alternative valuation methods could affect the reported fair value of these contracts.

***Interest rate movements and market performance affects our employee benefit plan costs.***

Prevailing interest rates affect our assessment and determination of discount rates that are a key assumption in the determination of the costs and funding of our defined benefit pension plans and may impact the amount of expense and timing of contributions to those plans. The performance of the capital markets affects the values of the assets that are held in trust to satisfy the future obligations under our pension and postretirement benefit plans. We have significant obligations in these areas and hold significant assets in these trusts. A decline in the market value of those assets may increase our current and longer-term funding requirements for these obligations. Changes in the value of trust fund assets may affect the level of required contributions to these trusts to meet benefit obligations. Reduced benefit plan assets could result in increased benefit costs in future years and may increase the amount and accelerate the timing of required future funding contributions.

***We are exposed to interest rate risk.***

We are exposed to interest rate risk on our variable rate financing. Borrowing levels under commercial paper arrangements vary from period to period depending upon capital investments and other factors. Such interest rate risk means that we are exposed to increased financing costs and associated cash payments as a result of changes in the short-term interest rates.

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*We are exposed to credit risk primarily through our regulated energy business.*

Credit risk is the loss that may result from counterparty nonperformance. We face credit risk primarily through MGE's regulated energy business. Failure of contractual counterparties to perform their obligations under purchase power agreements, commodity supply arrangements or other agreements may result in increased expenses for MGE as a result of being forced to cover the shortfall in the spot or short-term market, where prices may be more volatile.

*As a holding company, we are dependent on upstream cash flows from our subsidiaries for the payment of dividends on our common stock.*

As a holding company, we have no operations of our own, and our ability to pay dividends on our common stock is dependent on the earnings and cash flows of our operating subsidiaries and their ability to pay upstream dividends or to repay funds to us. Prior to funding us, our subsidiaries have financial obligations that must be satisfied, including among others, debt service and obligations to trade creditors, and are subject to contractual and regulatory restrictions on the payment of dividends.

*Disruptions in the financial markets or changes to our credit ratings may affect our ability to finance at a reasonable cost and in accordance with our planned schedule.*

The credit markets have experienced disruption and uncertainty in recent years. To the extent that such issues affect the ability or willingness of credit providers or investors to participate in the credit markets or particular types of investments, or affect their perception of the risk associated with particular types of investments, our cost of borrowing could be affected. We also rely on our strong credit ratings to access the credit markets. If our credit ratings are downgraded for any reason, borrowing costs could increase, potential investors could decrease, or we could be required to provide additional credit assurance, including cash collateral, to contract counterparties.

*General economic conditions may affect our operating revenues and our counterparty risks.*

*Operational*

MGE Energy's and MGE's operations are affected by local, national and worldwide economic conditions. The consequences of a prolonged period of reduced economic activity may include lower demand for energy, uncertainty regarding energy prices and the capital and commodity markets, and increased credit risk. A decline in energy consumption may adversely affect our revenues and future growth. Increased credit risk reflects the risk that our retail customers will not pay their bills in a timely manner or at all, which may lead to a reduction in liquidity and an eventual increase in bad debt expense.

*Counterparty creditworthiness*

Credit risk also includes the risk that trading counterparties that owe us money or product will breach their obligations. MGE's risk management policy is to limit transactions to a group of high quality counterparties. Should the counterparties to these arrangements fail to perform, we may be forced to enter into alternative arrangements. In that event, our financial results could be adversely affected and we could incur losses.

**Item 1B. Unresolved Staff Comments.**

**MGE Energy and MGE**

None.

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## Item 2. Properties.

### Electric Generation

Net summer rated capacity in service at December 31, 2016, was as follows:

Plants	Location	Commercial Operation Date	Fuel	Net Summer Rated Capacity (MW) <sup>(a)</sup>	No. of Units
Steam plants:					
Columbia	Portage, WI	1975 & 1978	Low-sulfur coal	225 <sup>(b,c)</sup>	2
Blount	Madison, WI	1957 & 1961	Gas	103 <sup>(g)</sup>	2
WCCF	Madison, WI	2005	Gas/oil	120 <sup>(d)</sup>	2
Elm Road Units	Oak Creek, WI	2010 & 2011	Coal	106 <sup>(b,e)</sup>	2
Combustion turbines	Madison, WI	1964-2000	Gas/oil	151 <sup>(f)</sup>	6
	Marinette, WI				
Portable generators	Madison, WI	1998-2001	Diesel	49 <sup>(g)</sup>	54
Wind turbines	Townships of Lincoln and Red River, WI	1999	Wind	1 <sup>(g,h)</sup>	17
	Township of Brookfield, IA	2008	Wind	4 <sup>(g,i)</sup>	18
Total				<u>759</u>	

- (a) Net summer rated capacity is determined by annual testing and may vary from year to year due to, among other things, the operating and physical conditions of the units.
- (b) Baseload generation.
- (c) MGE's share. See "Columbia" below.
- (d) Facility is jointly owned. Based on the terms of the joint plant agreement between MGE and the UW, the UW has the ability to reduce net capability of these units by approximately 17 MW in the summer. The net summer rated capacity shown reflects this decrease. See "WCCF" below.
- (e) MGE's share. See "Elm Road" below.
- (f) Three facilities are owned by MGE, and three facilities are leased.
- (g) These facilities are owned by MGE.
- (h) Nameplate capacity rating is 11 MW.
- (i) Nameplate capacity rating is 30 MW.

#### *Columbia*

MGE and two other utilities jointly own Columbia, a coal-fired generating facility consisting of two 512 MW units, which, at December 31, 2016, accounts for 30% of MGE's net summer rated capacity. Power from this facility is shared in proportion to each owner's ownership interest. At December 31, 2016, MGE had a 22% ownership interest in Columbia. The other owners are WPL, which operates Columbia, and WPSC. The Columbia units burn low-sulfur coal obtained from the Powder River Basin coal fields located in Wyoming. The coal inventory supply for the Columbia units decreased from approximately 88 days on December 31, 2015, to approximately 65 days on December 31, 2016. See "Executive Overview" under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, for a discussion of the reduction in MGE's ownership share in Columbia commencing January 2017 and continuing through June 2020.

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## *Elm Road Units*

MGE Power Elm Road and two other owners own undivided interests in the Elm Road Units, consisting of two 615 MW units, which, at December 31, 2016, account for 14% of MGE's net summer rated capacity. Power from these units is shared in proportion to each owner's ownership interest. MGE Power Elm Road owns an 8.33% ownership interest in the Elm Road Units, and its interest in the Elm Road Units is leased to MGE. The other owners are Wisconsin Energy Corporation, which operates the Units, and WPPI Energy, Inc. The Elm Road Units burn bituminous coal obtained from northern West Virginia and southwestern Pennsylvania, and Powder River Basin coal from Wyoming. MGE's share of the coal inventory supply for the Elm Road Units increased from approximately 50 days on December 31, 2015, to approximately 51 days on December 31, 2016.

MGE leases MGE Power Elm Road's ownership interest in the Elm Road Units pursuant to two separate facility leases. The financial terms of each facility lease include a capital structure of 55% equity and 45% long-term debt, return on equity of 12.7%, and a lease term of 30 years. At the end of the respective lease terms, MGE may, at its option, renew the facility lease for an additional term, purchase the leased ownership interest at fair market value, or allow the lease to end. The Unit 1 and Unit 2 leases commenced with the commercial operation of each respective unit.

## *WCCF*

MGE Power West Campus and the UW jointly own undivided interests in a natural gas-fired cogeneration facility on the UW campus. The facility has the capacity to produce 20,000 tons of chilled water, 500,000 pounds per hour of steam, and approximately 150 MW of electricity. The UW owns 45% of the facility, which represents its interest in the chilled-water and steam assets. These assets are used to meet a part of the UW's need for air-conditioning and steam-heat capacity. MGE Power West Campus owns 55% of the facility, which represents its interest in the electric generating assets. These assets are used to provide electricity to MGE's customers. The UW's share of the plant and portion of the earnings from the WCCF are not reflected in the consolidated financial statements of MGE Energy or MGE. MGE Power West Campus' share of the plant is reflected in property, plant, and equipment on MGE Energy's and MGE's consolidated balance sheets.

MGE leases the electric generating assets owned by MGE Power West Campus and is responsible for operating the entire facility. The financial terms of the facility lease include a capital structure of 53% equity and 47% long-term debt, return on equity of 12.1%, and a lease term of 30 years. At the end of the lease term in 2035, MGE may, at its option, renew the facility lease for an additional term, purchase the generating facility at fair market value, or allow the lease contract to end.

## **Electric and Gas Distribution Facilities**

At December 31, 2016, MGE owned 872 miles of overhead electric distribution line and 1,236 miles of underground electric distribution cable, all of which are located in Wisconsin. These electric distribution facilities are connected by approximately 52 substations, installed with a capacity of 1,190,500 kVA. MGE's gas facilities include 2,765 miles of distribution mains, which are all owned by MGE.

A significant portion of MGE's electric and gas distribution facilities are located above or underneath highways, streets, other public places or property that others own. MGE believes that it has satisfactory rights to use those places or property in the form of permits, grants, easements, and licenses; however, it has not necessarily undertaken to examine the underlying title to the land upon which the rights rest.

## **Encumbrances**

The principal plants and properties of MGE are subject to the lien of its Indenture of Mortgage and Deed of Trust dated as of January 1, 1946, as amended and supplemented, under which MGE's first mortgage bonds are issued. As of December 31, 2016, there were \$1.2 million of first mortgage bonds outstanding. See Footnote 9 of the Notes to Consolidated Financial Statements for additional information regarding MGE's first mortgage bonds.

MGE Power Elm Road has collaterally assigned its right to lease payments from MGE for the Elm Road Units in order to secure the repayment of \$62.6 million of senior secured notes issued by MGE Power Elm Road. See Footnote 9 of the Notes to Consolidated Financial Statements for additional information regarding these senior notes.

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MGE Power West Campus has collaterally assigned its right to lease payments from MGE for the WCCF in order to secure the repayment of \$45.1 million of senior secured notes issued by MGE Power West Campus. See Footnote 9 of the Notes to Consolidated Financial Statements for additional information regarding these senior notes.

**Item 3. 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 "Environmental" under Item 1. Business and Footnote 17.c. of the Notes to Consolidated Financial Statements for a description of several environmental proceedings involving MGE. See Footnote 17.d. of the Notes to Consolidated Financial Statements for a description of other legal matters.

**Item 4. Mine Safety Disclosures.**

**MGE Energy and MGE**

Not applicable.

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## PART II.

### Item 5. Market for Registrants' Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.

#### Market for Common Equity

##### *MGE Energy*

MGE Energy common stock is traded on Nasdaq under the symbol MGEE. On February 1, 2017, there were approximately 38,688 shareholders of record. The following table shows high and low sale prices for the common stock on Nasdaq for each quarter over the past two years.

	Common Stock Price Range			
	2016		2015	
	High	Low	High	Low
Fourth quarter	\$ 66.85	\$ 53.48	\$ 47.23	\$ 39.18
Third quarter	\$ 59.49	\$ 53.78	\$ 41.97	\$ 36.75
Second quarter	\$ 56.54	\$ 47.90	\$ 45.33	\$ 36.46
First quarter	\$ 53.48	\$ 44.83	\$ 47.97	\$ 40.66

##### *MGE*

As of February 1, 2017, there were 17,347,894 outstanding shares of common stock, all of which were held by MGE Energy. There is no market for shares of common stock of MGE.

#### Dividends

##### *MGE Energy*

The following table sets forth MGE Energy's quarterly cash dividends per share declared during 2016 and 2015:

<i>(Per share)</i>	2016	2015
Fourth quarter	\$ 0.308	\$ 0.295
Third quarter	\$ 0.308	\$ 0.295
Second quarter	\$ 0.295	\$ 0.283
First quarter	\$ 0.295	\$ 0.283

##### *MGE*

The following table sets forth MGE's quarterly cash dividends declared during 2016 and 2015:

<i>(In thousands)</i>	2016	2015
Fourth quarter	\$ 10,000	\$ 10,000
Third quarter	\$ 15,000	\$ 10,000
Second quarter	\$ 15,000	\$ 10,000
First quarter	\$ 10,000	\$ -

See discussion below as well as "Liquidity and Capital Resources - Financing Activities" under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, for a description of restrictions applicable to dividend payments by MGE.

#### *Dividend Restrictions*

Dividend payments by MGE to MGE Energy are subject to restrictions arising under a PSCW rate order and, to a lesser degree, MGE's first mortgage bonds. The PSCW order restricts any dividends, above the PSCW authorized amount of \$43 million, that MGE may pay MGE Energy if its common equity ratio, calculated in the manner used in the rate proceeding, is less than 55%. MGE's thirteen month rolling average common equity ratio at December 31, 2016, is 60.2%, as determined under the calculation used in the rate proceeding. This restriction did not impact

MGE's payment of dividends in 2016. Cash dividends of \$50.0 million and \$30.0 million were paid by MGE to MGE Energy in 2016 and 2015, respectively. In 2016, MGE also transferred its ownership interest in MGE Transco to MGE Energy in the form of a dividend in kind of \$15.8 million. The rate proceeding calculation includes as indebtedness imputed amounts for MGE's outstanding purchase power capacity payments and other PSCW adjustments, but does not include the indebtedness associated with MGE Power Elm Road and MGE Power West Campus, which are consolidated into MGE's financial statements but are not direct obligations of MGE.

MGE has covenanted with the holders of its first mortgage bonds not to declare or pay any dividend or make any other distribution on or purchase any shares of its common stock unless, after giving effect thereto, the aggregate amount of all such dividends and distributions and all amounts applied to such purchases, after December 31, 1945, shall not exceed the earned surplus (retained earnings) accumulated subsequent to December 31, 1945. As of December 31, 2016, approximately \$338.5 million was available for the payment of dividends under this covenant.

### ***Stock Split***

On December 20, 2013, MGE Energy's Board of Directors declared a three-for-two stock split of MGE Energy's outstanding shares of common stock, effective in the form of a stock dividend. Shareholders of record at the close of business on January 24, 2014, received one additional share of MGE Energy common stock for every two shares of common stock owned on that date. The additional shares were distributed on February 7, 2014. Shareholders received cash in lieu of any fractional shares of common stock they otherwise would have received in connection with the dividend. All share and per share data provided in this report give effect to this stock split.

### **Issuer Purchases of Equity Securities**

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

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*
October 1-31, 2016	21,025	\$ 55.21	-	-
November 1-30, 2016	15,905	60.17	-	-
December 1-31, 2016	55,400	64.86	-	-
Total	92,330	\$ 61.85	-	-

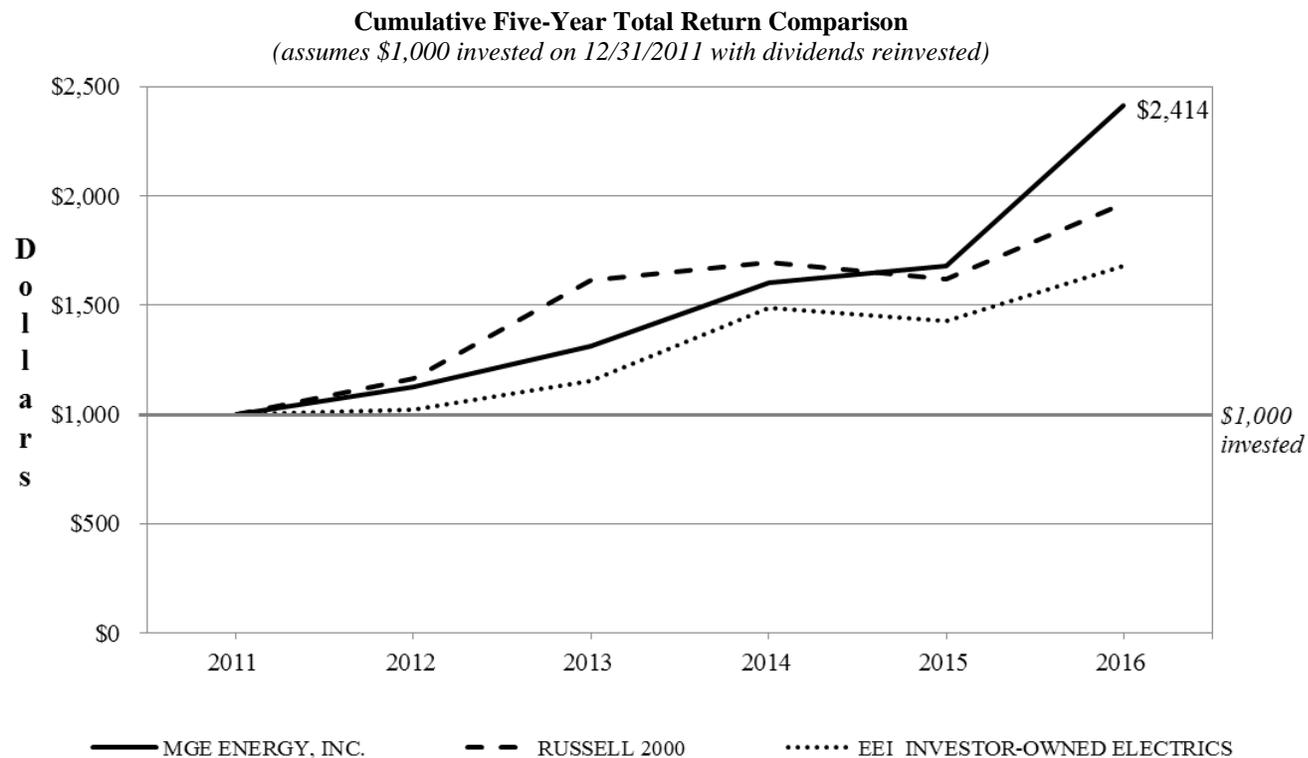
\* Under the MGE Energy, Inc. Direct Stock Purchase and Dividend Reinvestment Plan (Stock Plan), common stock shares deliverable to plan participants may be either newly issued shares or shares purchased on the open market, as determined from time to time by MGE Energy. MGE Energy uses open market purchases 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 by MGE Energy pursuant to a registration statement that was filed with the SEC and is currently effective.

#### ***MGE***

None.

## Stock Performance Graph

The performance graph below illustrates a five-year comparison of cumulative total returns based on an initial investment of \$1,000 in MGE Energy common stock, as compared with the Russell 2000 and the EEI Index for the period 2011 through 2016. The EEI Index reflects the consolidated performance of Edison Electric Institute investor-owned electric utilities.



### Value of Investment at December 31,

	2011	2012	2013	2014	2015	2016
MGEE	\$ 1,000	\$ 1,126	\$ 1,315	\$ 1,602	\$ 1,677	\$ 2,414
Russell 2000	1,000	1,163	1,615	1,694	1,619	1,965
EEI Index	1,000	1,021	1,154	1,487	1,429	1,678

## Item 6. Selected Financial Data.

### MGE Energy, Inc.

(In thousands, except per share amounts)

	For the Years Ended December 31,				
	2016	2015	2014	2013	2012
<b>Summary of Operations</b>					
Operating revenues:					
Electric .....	\$ 410,202	\$ 420,291	\$ 398,132	\$ 409,425	\$ 401,596
Gas .....	134,543	143,737	221,720	181,462	139,727
Total operating revenues.....	544,745	564,028	619,852	590,887	541,323
Operating expenses .....	396,455	419,894	462,102	444,293	410,200
Other general taxes .....	20,062	19,879	19,652	18,607	18,360
Operating income .....	128,228	124,255	138,098	127,987	112,763
Other income, net .....	9,711	8,613	10,079	10,701	10,069
Interest expense, net.....	(19,866)	(20,162)	(19,673)	(18,924)	(19,467)
Income before taxes.....	118,073	112,706	128,504	119,764	103,365
Income tax provision.....	(42,513)	(41,363)	(48,185)	(44,859)	(38,919)
Net income .....	\$ 75,560	\$ 71,343	\$ 80,319	\$ 74,905	\$ 64,446
Average shares outstanding.....	34,668	34,668	34,668	34,668	34,668
Basic and diluted earnings per share .....	\$ 2.18	\$ 2.06	\$ 2.32	\$ 2.16	\$ 1.86
Dividends declared per share .....	\$ 1.21	\$ 1.16	\$ 1.11	\$ 1.07	\$ 1.04
<b>Assets<sup>(a)</sup></b>					
Electric .....	\$ 1,021,905	\$ 974,235	\$ 945,790	\$ 896,864	\$ 889,889
Gas.....	318,603	298,435	306,106	264,099	282,815
Assets not allocated.....	27,338	49,753	41,124	19,853	18,549
Nonregulated energy operations .....	271,277	277,858	280,542	287,042	290,889
Transmission investments .....	74,535	69,470	67,697	64,504	61,064
All others .....	465,202	434,868	438,898	431,436	412,840
Eliminations .....	(377,800)	(378,216)	(390,636)	(389,800)	(397,372)
Total assets.....	\$ 1,801,060	\$ 1,726,403	\$ 1,689,521	\$ 1,573,998	\$ 1,558,674
<b>Capitalization including Short-Term Debt</b>					
Common shareholders' equity .....	\$ 724,088	\$ 690,458	\$ 659,401	\$ 617,510	\$ 579,429
Long-term debt <sup>(a,b)</sup> .....	387,124	391,010	394,775	398,454	356,737
Short-term debt.....	-	-	7,000	-	-
Total capitalization and short-term debt .....	\$ 1,111,212	\$ 1,081,468	\$ 1,061,176	\$ 1,015,964	\$ 936,166

(a) Reflects retrospective application of new accounting pronouncement related to debt issuance costs. See Footnote 19 of the Notes to the Consolidated Financial Statements for additional information.

(b) Includes long-term debt due within one year, debt issuance costs, and unamortized discount.

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## **Item 7. 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 ATC Holdco, 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 149,000 customers in Dane County, Wisconsin, including the city of Madison, and purchases and distributes natural gas to approximately 154,000 customers in the Wisconsin counties of Columbia, Crawford, Dane, Iowa, Juneau, Monroe, and Vernon.

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

### ***Executive Overview***

Our primary focus today and for the foreseeable future is our core utility customers at MGE as well as creating long-term value for our shareholders. MGE continues to face the challenge of providing its customers with reliable power at competitive prices. MGE meets this challenge by investing in more efficient generation projects, including renewable energy sources. MGE will continue to focus on growing earnings while controlling operating and fuel costs. MGE maintains 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,
- 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, including natural gas 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, and
- Other factors listed in Item 1A. Risk Factors.

For the year ended December 31, 2016, MGE Energy's earnings were \$75.6 million or \$2.18 per share compared to \$71.3 million or \$2.06 per share for the same period in the prior year. MGE's earnings for the year ended December 31, 2016, were \$51.2 million compared to \$45.4 million for the same period in the prior year.

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

<i>(In millions)</i> <b>Business Segment:</b>	Year Ended December 31,		
	2016	2015	2014
Electric Utility .....	\$ 40.6	\$ 36.4	\$ 41.4
Gas Utility .....	10.6	10.4	15.8
Nonregulated Energy .....	19.1	20.1	19.3
Transmission Investments .....	5.6	4.6	5.5
All Others.....	(0.3)	(0.2)	(1.7)
Net Income .....	<u>\$ 75.6</u>	<u>\$ 71.3</u>	<u>\$ 80.3</u>

Our net income during 2016 compared to 2015 primarily reflects the effects of the following factors:

- Electric net income increased due to a 5.4% increase in residential electric retail sales as the result of more favorable weather conditions in 2016 compared to 2015. Electric utility operations experienced an increase in operating and maintenance costs partially offsetting the increase in net income compared to the same period in the prior year.
- Carrying costs incurred during construction of the Elm Road Units and WCCF were recognized by MGE Power Elm Road and MGE Power West Campus over the period allowed for recovery in rates. The recovery period ended in 2015, contributing to a reduction in nonregulated earnings in 2016. The reduction in earnings was partially offset by an increase in lease revenue.
- Transmission investment income reflects our share of ATC's earnings. ATC's earnings for 2015 reflected a charge representing its estimate of its refund liability covering 2015, 2014, and a portion of 2013 associated with the return on equity complaint filed with FERC. See "Other Matters" below for additional information concerning ATC.

Our net income during 2015 compared to 2014 primarily reflects the effects of the following factors:

- Electric net income decreased due to lower AFUDC and higher depreciation expense primarily related to the Columbia environmental project being placed in service in April (Unit 2) and July 2014 (Unit 1). In addition, there was a 0.3% decrease in electric retail sales in 2015 compared to 2014.
- Gas net income decreased due to a 27.0% decrease in gas retail sales reflecting lower customer demand compared to the demand resulting from the extremely cold weather experienced in 2014. Heating degree days (a measure for determining the impact of weather during the heating season) decreased by 18.9% compared to 2014. The average temperature in January 2015 was 20.1 degrees compared to 11.5 degrees in 2014.
- ATC's earnings for 2015 reflected a charge representing its estimate of its refund liability covering 2015, 2014, and a portion of 2013 associated with the return on equity complaint filed with FERC. See "Other Matters" below for additional information concerning ATC.
- The increase in all other income primarily results from a decrease in voluntary contributions.

During 2016, the following events occurred:

**2016 Rates:** In July 2015, the PSCW approved MGE's request to extend the current accounting treatment for transmission related costs through 2016, conditioned upon MGE not filing a base rate case for 2016. This accounting treatment allows MGE to reflect any differential between transmission costs reflected in rates and actual costs incurred in its next rate case filing.

**2016 Annual Fuel Proceeding:** In August 2015, the PSCW approved a \$0.00256/kWh fuel credit that began on September 1, 2015, and continued throughout 2016. The fuel credit established a mechanism to return \$10.9 million of fuel savings to electric customers as a bill credit. MGE returned \$8.3 million of electric fuel-related savings to customers through bill credits during the year ended December 31, 2016.

In January 2016, the PSCW lowered MGE's 2016 fuel rules monitored costs by \$14.8 million as a result of continued lower projected fuel costs in 2016. Also, in March 2016, MGE filed its 2015 fuel plan reconciliation application showing an overcollection of 2015 fuel rules monitored costs. In July 2016, the PSCW issued a final

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order stating that MGE shall refund the additional fuel savings incurred during 2015 and 2016 for a total of \$15.7 million to its retail electric customers over a one-month period. In September 2016, MGE returned \$15.5 million to customers through bill credits.

As of December 31, 2016, MGE has deferred \$5.6 million of 2016 fuel savings that were in excess of the fuel savings included within the fuel credits referenced above. These costs will be subject to the PSCW's annual review of 2016 fuel costs, expected to be completed in 2017.

**Loss of Industrial Customer:** In November 2015, a large industrial customer announced its intention to relocate its operations out of state and to close its manufacturing facilities within our service territory. That closure is expected to occur in early 2017. For the years ended December 31, 2016 and 2015, this customer contributed approximately \$3.4 million and \$3.8 million, respectively, of pre-tax earnings. Our rate case filing for 2017 addressed the effects of the closure.

**ATC Return on Equity:** Several parties have filed complaints with the FERC seeking to reduce the base return on equity (ROE) used by MISO transmission owners, including ATC. In June 2016, an administrative law judge issued an initial decision regarding a second filed complaint for the period February 2015 through May 2015 that would reduce the transmission owners' base ROE to 9.7%. ATC recorded an estimated refund liability with respect to the administrative law judge's order, which was reflected within our share of ATC earnings. On September 28, 2016, FERC issued an order on the first complaint, for the period November 2013 through February 2015, reducing the base ROE to 10.32%. This base ROE also became effective September 28, 2016, and will apply to future periods until FERC rules in the second complaint, at which time the base ROE ordered by FERC in the second complaint will prospectively become the authorized base ROE. See "Other Matters" below for additional information concerning ATC.

During 2017, several items may affect us, including:

**2017 Rate Case Filing:** On December 15, 2016, the PSCW authorized MGE to decrease 2017 rates for retail electric customers by 0.8% or \$3.3 million and to increase rates for retail gas customers by 1.9% or \$3.1 million. The decrease in retail electric rates reflects declining fuel and purchased power costs. The increase in retail gas rates covers costs associated with MGE's natural gas system infrastructure improvements. The authorized return on common stock equity for 2017 is 9.8% on 57.2% common equity. The PSCW also approved MGE's request to extend the current accounting treatment for transmission related costs through 2018.

**ATC Return on Equity:** Several parties have filed complaints with the FERC seeking to reduce the ROE used by MISO transmission owners, including ATC. Any change to ATC's ROE could result in lower equity earnings and distributions from ATC in the future. We derived approximately 6.8% and 6.4% of our net income for the years ended December 31, 2016 and 2015, respectively, from our investment in ATC. See "Other Matters" below for additional information concerning ATC.

**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. At present, it is unclear how the changes in the Presidential and EPA administration may affect pending or new legislative or rulemaking proposals or regulatory initiatives. Such legislation and rulemaking could significantly affect the costs of owning and operating fossil-fueled generating plants, such as Columbia and the Elm Road Units, from which we derive approximately 43% of our electric generating capacity as of December 31, 2016. 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, which may lag the incurrence of those costs.

**EPA's Clean Power Plan:** In October 2015, the EPA finalized its Clean Power Plan (CPP) rule with an effective date of December 2015, setting guidelines and approval criteria for states to use in developing plans to control GHG emissions from existing fossil fuel-fired electric generating units (EGUs) and systems. Implementation of the rule is expected to have a direct impact on existing coal and natural gas fired generating units, including possible changes in dispatch and additional operating costs. Given the pending legal proceedings, the nature and timing of any final requirements is subject to uncertainty. If the rule remains substantially in its present form, it is expected to have a material impact on MGE.

Future Generation: During the first quarter of 2016, MGE entered into an agreement with WPL under which MGE may acquire up to 50 MW of capacity in a gas-fired generating plant to be constructed by WPL at its Riverside Energy Center in Beloit, Wisconsin, during the five-year period following the in-service date of the plant. The plant is expected to be completed by early 2020. MGE and WPL have negotiated an amendment to the existing Columbia joint operating agreement, effective January 1, 2017, under which MGE will reduce its obligation to pay certain capital expenditures (other than SCR-related expenditures) at Columbia prior to the expected in-service date of the Riverside gas-fired generating plant in exchange for a proportional reduction in MGE's ownership in Columbia. On January 1 of each year, beginning in 2017 and ending June 1, 2020, the ownership percentage will be adjusted, through a partial sale, based on the amount of capital expenditures foregone. During 2016, MGE accrued \$14.8 million of 2016 capital expenditures that MGE has forgone as part of the ownership transfer agreement with WPL. As of December 31, 2016, MGE classified \$14.8 million of Columbia assets as held-for-sale on the consolidated balance sheets. In January 2017, MGE reduced its ownership interest in Columbia from 22.0% to 20.4% through the partial sale of plant assets to WPL. By June 2020, MGE's ownership in Columbia is forecasted to be approximately 19%.

Saratoga Wind Farm: On February 21, 2017, MGE filed with the PSCW a letter notifying the commission of MGE's intent to seek approval to construct, own and operate a 66MW wind farm, consisting of 33 turbines, located near Saratoga, Iowa. MGE anticipates filing its formal application with the PSCW in March. If approved, construction of the project is expected to begin in early 2018, with an estimated capital cost of \$107 million.

Financing Plans: In January 2017, MGE issued \$40 million of new long-term unsecured debt carrying an interest rate of 3.76% per annum over its 35-year term. The proceeds of this debt financing were used to refinance the maturing \$30 million medium-term notes and, assist with the financing of additional capital expenditures. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt. In accordance with applicable accounting guidance, MGE has classified the \$30 million of maturing medium-term notes as long-term debt on the consolidated balance sheets for 2016. MGE also plans to issue an additional \$30 million of new long-term debt during 2017 to cover capital expenditures and other corporate obligations.

The following discussion is based on the business segments as discussed in Footnote 20 of the Notes to Consolidated Financial Statements.

## Results of Operations

### Year Ended December 31, 2016, Versus the Year Ended December 31, 2015

#### 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 years indicated:

	Revenues			Sales (kWh)		
	2016	2015	% Change	2016	2015	% Change
<i>(In thousands, except cooling degree days)</i>						
Residential .....	\$ 136,792	\$ 135,201	1.2 %	828,887	786,741	5.4 %
Commercial .....	213,101	220,745	(3.5)%	1,866,035	1,831,251	1.9 %
Industrial .....	17,589	20,283	(13.3)%	232,854	248,443	(6.3)%
Other-retail/municipal .....	35,559	38,824	(8.4)%	395,662	422,188	(6.3)%
Total retail .....	403,041	415,053	(2.9)%	3,323,438	3,288,623	1.1 %
Sales to the market .....	6,135	2,154	N/A%	183,195	68,886	N/A%
Return of fuel savings .....	(423)	-	-%	-	-	-%
Adjustments to revenues .....	253	(4,679)	(105.4)%	-	-	-%
Total .....	\$ 409,006	\$ 412,528	(0.9)%	3,506,633	3,357,509	4.4 %
Cooling degree days (normal 647) ...				780	666	17.1 %

Electric operating revenues decreased \$3.5 million or 0.9% during 2016, due to the following:

(In millions)

Deferral of fuel savings/fuel credit.....	\$ (21.5)
Volume.....	6.7
Adjustments to revenues.....	4.9
Sales to the market.....	4.0
Other.....	2.4
Total .....	\$ <u>(3.5)</u>

In July 2015, the PSCW authorized MGE to freeze 2016 rates at 2015 levels for retail electric customers.

- *Deferral of fuel savings/fuel credit.* During 2016, customers received a fuel credit on their bill related to the fuel savings of \$21.1 million, which decreased electric revenues when compared to 2015. This amount was partially offset by the 2016 deferred fuel rules monitored costs. In January 2016, the PSCW lowered MGE's 2016 fuel rules monitored costs as a result of continued lower projected fuel costs in 2016.
- *Volume.* During 2016, there was a 5.4% increase in total residential sales volumes compared to the same period in the prior year driven by increased customer demand due, at least in part, to more favorable weather conditions, as evidenced by the higher number of cooling degree days.
- *Adjustments to Revenue.* The adjustments to revenues amount includes the elimination of carrying costs for the Elm Road Units and the WCCF that were collected in electric rates ending in 2015, which were recognized as operating revenues in our Nonregulated Energy Operations segment.

MGE leases electric generating capacity from MGE Power Elm Road. MGE collects in rates the lease payments associated with the electric generating capacity as authorized by the PSCW. Any differential between estimated lease payments collected in rates and actual lease payments paid to MGE Power Elm Road are included in adjustments to revenues.

- *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. These sales may also include bilateral sales to other utilities or power marketers. Generating units are dispatched by MISO based on cost considerations as well as reliability of the system. Sales to the market typically occur when MGE has more generation and purchases online than are needed for its own system demand. The excess electricity is then sold to others in the market. For 2016, market volumes increased compared to the same period in the prior year, reflecting increased opportunities for sales, and those sales were made at higher market prices. The revenue generated from these sales is included in fuel rules monitored costs. See fuel rules discussion in Footnote 16.b. of the Notes to Consolidated Financial Statements.
- *Other.* During 2016, other items affecting electric operating revenues increased \$2.4 million. MGE experienced an increase in residential and small commercial customers contributing to the increase in other electric revenue. Higher monthly on-peak sales also attributed to the increase.

### ***Electric fuel and purchased power***

Electric fuel and purchased power costs reflect an increase in internal generation volumes partially offset by a decrease in the volume of purchased power when compared to the prior year. Adjustments related to the regulatory recovery for fuel costs, known as fuel rules, decreased purchased power expense. These items are explained below.

#### Fuel for electric generation

The expense for fuel for internal electric generation increased \$6.9 million during 2016 compared to 2015 due to the following:

(In millions)

Increase in volume.....	\$ 10.5
Decrease in per-unit cost .....	<u>(3.6)</u>
Total .....	\$ <u>6.9</u>

This increase in expense reflects a 21.0% increase in internal generation volume delivered to the system primarily as a result of increased generation at WCCF based on market prices, partially offset by a 6.8% decrease in per-unit cost of internal electric generation, reflective of lower natural gas prices.

#### Purchased power

Purchased power expense decreased \$24.9 million during 2016 compared to 2015 due to the following:

<i>(In millions)</i>	
Decrease in volume .....	\$ (15.2)
Increase in per-unit cost .....	3.0
Change in fuel rule adjustments, net of recoveries .....	<u>(12.7)</u>
Total .....	<u>\$ (24.9)</u>

The decrease in expense (before fuel rules adjustments) reflects a 21.1% decrease in the volume of power purchased from third parties primarily as a result of the increased internal generation, partially offset by a 5.2% increase in the per-unit cost of purchased power.

Under fuel rules, MGE is required 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.

#### *Electric operating and maintenance expenses*

Electric operating and maintenance expenses increased \$2.5 million during 2016 compared to 2015. The following changes contributed to the net change:

<i>(In millions)</i>	
Increased customer accounts costs .....	\$ 0.9
Increased production costs .....	0.7
Increased distribution costs .....	0.5
Increased other costs.....	<u>0.4</u>
Total .....	<u>\$ 2.5</u>

For 2016, increased customer accounts costs are primarily related to higher customer billing expenses.

#### *Electric depreciation expense*

Electric depreciation expense decreased \$0.8 million for 2016, compared to the prior year. A new depreciation study approved by the PSCW, effective January 1, 2016, resulted in a decrease in expense.

### **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 years indicated:

<i>(In thousands, except HDD and average rate per therm of retail customer)</i>	Revenues			Therms Delivered		
	2016	2015	% Change	2016	2015	% Change
Residential .....	\$ 81,014	\$ 85,438	(5.2)%	91,791	92,970	(1.3)%
Commercial/Industrial .....	48,497	53,161	(8.8)%	86,641	88,489	(2.1)%
Total retail .....	129,511	138,599	(6.6)%	178,432	181,459	(1.7)%
Gas transportation .....	4,635	4,652	(0.4)%	72,922	75,572	(3.5)%
Other revenues .....	397	486	(18.3)%	-	-	-%
Total .....	<u>\$ 134,543</u>	<u>\$ 143,737</u>	(6.4)%	<u>251,354</u>	<u>257,031</u>	(2.2)%
Heating degree days (normal 7,083).....				6,417	6,395	0.3 %
Average rate per therm of retail customer . \$	0.726	\$ 0.764	(5.0)%			

Gas revenues decreased \$9.2 million or 6.4% during 2016. These changes are related to the following factors:

(In millions)

Rate/PGA changes .....	\$	(5.6)
Volume.....		(3.5)
Transportation and other effects .....		(0.1)
Total .....	\$	<u>(9.2)</u>

- *Rate/PGA changes.* MGE recovers the cost of natural gas in its gas segment through the purchased gas adjustment clause (PGA). Under the PGA, MGE is able to pass through to its gas customers the cost of gas. Changes in PGA recoveries affect revenues but do not impact net income.

The average retail rate per therm for 2016, decreased 5.0% compared to 2015, reflecting a \$6.3 million decrease in natural gas commodity costs (recovered through the PGA), partially offset by an increase in fixed rate charges.

- *Volume.* For 2016, retail gas deliveries decreased 1.7% compared to the prior year.

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

For 2016, cost of gas sold decreased by \$9.3 million, compared to the prior year. The cost per therm of natural gas decreased 10.3%, which resulted in \$7.6 million of decreased expense. The volume of gas purchased decreased 2.2%, which resulted in \$1.7 million of decreased expense.

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

Gas operating and maintenance expenses increased \$1.0 million for 2016 compared to 2015. The following changes contributed to the net change.

(In millions)

Increased customer accounts costs .....	\$	0.8
Increased administrative and general costs.....		0.5
Decreased distribution costs .....		(0.3)
Total .....	\$	<u>1.0</u>

For 2016, increased customer accounts costs are due to higher customer billing expenses.

### ***Gas depreciation expense***

Gas depreciation expense increased \$1.4 million for 2016, compared to the prior year. This increase is primarily driven by an increase in gas utility plant in-service in 2016 and a new depreciation study approved by the PSCW, effective January 1, 2016.

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

For 2016 and 2015, net income at the nonregulated energy operations segment was \$19.1 million and \$20.1 million, respectively. The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power Elm Road (the Elm Road Units) and MGE Power West Campus (WCCF), which have been formed to own and lease electric generating capacity to assist MGE. Carrying costs incurred during construction of the Elm Road Units and WCCF were recognized by MGE Power Elm Road and MGE Power West Campus over the period allowed for recovery in rates. The recovery period ended in 2015, contributing to a reduction in nonregulated earnings in 2016. The reduction in earnings was partially offset by an increase in lease revenue.

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

#### ***Transmission investment other income***

For 2016 and 2015, other income at the transmission investment segment was \$8.4 million and \$7.7 million, respectively. The transmission investment segment holds our interest in ATC and ATC Holdco, and its income reflects our equity in the earnings of ATC. ATC Holdco was formed in 2016. In the near term, it is expected that ATC Holdco will be pursuing transmission development opportunities that typically have long development and

investment lead times before becoming operational. See Footnote 4.b. of the Notes to Consolidated Financial Statements and "Other Matters" below for additional information concerning the transmission investments and summarized financial information regarding ATC.

### Consolidated Income Taxes - MGE Energy and MGE

MGE Energy's effective income tax rate for 2016 and 2015 was 36.0% and 36.7%, respectively. MGE's effective income tax rate for 2016 and 2015 was 35.9% and 36.7%, respectively. The decrease in the effective tax rate is due in part to a combination of individually insignificant fluctuations. See Footnote 12 of the Notes to Consolidated Financial Statements for details of effective income tax rates for continuing operations.

### 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 with respect to MGE 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, which holds our investment in ATC. The following table shows MGE Energy's noncontrolling interest, net of tax, reflected on MGE's consolidated statements of income:

<i>(In millions)</i>	Year Ended December 31,	
	2016	2015
MGE Power Elm Road .....	\$ 14.8	\$ 16.6
MGE Power West Campus .....	\$ 7.2	\$ 7.3
MGE Transco <sup>(a)</sup> .....	\$ 1.4	\$ 2.2

- (a) MGE Transco holds an ownership interest in ATC. In July 2016, MGE's ownership interest in MGE Transco declined below a majority, resulting in MGE Energy's investment in MGE Transco being deconsolidated from MGE's consolidated financial statements. See Footnote 8 of the Notes to Consolidated Financial Statements for further discussion of noncontrolling interest. In December 2016, MGE's ownership interest in MGE Transco was transferred to MGE Energy, see Footnote 4 of the Notes to Consolidated Financial Statements for additional information.

## Results of Operations

### Year Ended December 31, 2015, Versus the Year Ended December 31, 2014

#### 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 years indicated:

<i>(In thousands, except cooling degree days)</i>	Revenues			Sales (kWh)		
	2015	2014	% Change	2015	2014	% Change
Residential .....	\$ 135,201	\$ 132,359	2.1 %	786,741	807,265	(2.5)%
Commercial .....	220,745	210,141	5.0 %	1,831,251	1,834,473	(0.2)%
Industrial .....	20,283	19,163	5.8 %	248,443	246,267	0.9 %
Other-retail/municipal .....	38,824	36,281	7.0 %	422,188	409,737	3.0 %
Total retail .....	415,053	397,944	4.3 %	3,288,623	3,297,742	(0.3)%
Sales to the market .....	2,154	2,547	(15.4)%	68,886	68,727	0.2 %
Other revenues .....	1,705	1,489	14.5 %	-	-	-%
Adjustments to revenues .....	(6,384)	(7,131)	10.5 %	-	-	-%
Total .....	\$ 412,528	\$ 394,849	4.5 %	3,357,509	3,366,469	(0.3)%
Cooling degree days (normal 665) ...				666	620	7.4 %

Electric operating revenues increased \$17.7 million or 4.5% during 2015 compared to 2014 due to the following:

(In millions)

Rate changes .....	\$	14.4
Fuel credit.....		3.9
Adjustments to revenues.....		0.8
Other revenues .....		0.4
Volume.....		(1.4)
Sales to the market.....		(0.4)
Total .....	\$	<u>17.7</u>

- *Rate changes.* Rates charged to retail customers for 2015 were \$14.4 million or 3.6% higher than those charged during 2014.

In December 2014, the PSCW authorized MGE to increase 2015 rates for retail electric customers by \$15.4 million or 3.8%.

- *Fuel Credit.* During 2015 and 2014, customers received a fuel credit on their bill related to the fuel savings of \$2.6 million and \$6.5 million, respectively, which increased electric revenues when compared to 2014.
- *Adjustments to Revenue.* The adjustments to revenues amount includes the elimination of carrying costs for the 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.
- *Volume.* During 2015, there was a 0.3% decrease in total retail sales volumes compared to 2014 primarily driven by lower use per residential customer.
- *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. These sales may also include bilateral sales to other utilities or power marketers. Generating units are dispatched by MISO based on cost considerations as well as reliability of the system. Sales to the market typically occur when MGE has more generation and purchases online than are needed for its own system demand. The excess electricity is then sold to others in the market. For 2015, market volumes increased compared to 2014, reflecting increased opportunities for sales. In addition, market settlement resulted in lower revenue per kWh for 2015, reflecting lower market prices. The revenue generated from these sales is included in fuel rules monitored costs. See fuel rules discussion in Footnote 16.b. of the Notes to Consolidated Financial Statements.

### ***Electric fuel and purchased power***

Electric fuel and purchased power costs reflect an increase in internal generation volumes during 2015 partially offset by a decrease in the volume of purchased power when compared to 2014. Adjustments related to the regulatory recovery for fuel costs, known as fuel rules, increased purchased power expense. These items are explained below.

#### **Fuel for electric generation**

The expense for fuel for internal electric generation increased \$11.0 million during 2015 compared to 2014 due to the following:

(In millions)

Increase in per-unit cost .....	\$	5.8
Increase in volume.....		<u>5.2</u>
Total .....	\$	<u>11.0</u>

This increase in expense reflects a 13.6% increase in per-unit cost of internal electric generation primarily at Columbia and a 10.7% increase in internal generated volume delivered to the system.

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### Purchased power

Purchased power expense increased \$8.0 million during 2015 compared to 2014 due to the following:

*(In millions)*

Decrease in volume .....	\$ (11.0)
Decrease in per-unit cost.....	(2.8)
Change in fuel rule adjustments, net of recoveries .....	21.8
Total.....	<u>\$ 8.0</u>

The decrease in expense (before fuel rules adjustments) reflects a 3.8% decrease in the per-unit cost of purchased power and a 12.8% decrease in the volume of power purchased from third parties primarily as a result of increased internal generation.

Under fuel rules, MGE is required 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.

### ***Electric operating and maintenance expenses***

Electric operating and maintenance expenses increased \$4.0 million during 2015 compared to 2014. The following changes contributed to the net change:

*(In millions)*

Increased transmission costs.....	\$ 3.3
Increased administrative and general costs .....	1.6
Increased customer service costs.....	0.5
Increased production costs .....	0.1
Decreased customer accounts costs .....	(1.5)
Total .....	<u>\$ 4.0</u>

For 2015, increased transmission costs are primarily related to an increase in transmission reliability enhancements. In addition, increased administrative and general costs are primarily due to increased pension and other postretirement benefits costs predominantly driven by a reduction in the discount rate, which has the effect of increasing the related costs. Decreased customer account costs are primarily related to lower uncollectible accounts receivable.

### ***Electric depreciation expense***

Electric depreciation expense increased \$3.0 million for 2015 compared to 2014. This increase is primarily related to the completion of the Columbia environmental project. The systems and equipment for Unit 2 and Unit 1 were placed into service in April 2014 and July 2014, respectively.

### ***Other Electric Income***

Other electric income decreased \$2.4 million, primarily due to AFUDC equity related to the completion of the Columbia environmental project. Unit 2 and Unit 1 were placed into service in April and July 2014, respectively.

## 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 years indicated:

<i>(In thousands, except HDD and average rate per therm of retail customer)</i>	Revenues			Therms Delivered		
	2015	2014	% Change	2015	2014	% Change
Residential .....	\$ 85,438	\$ 117,523	(27.3)%	92,970	110,422	(15.8)%
Commercial/Industrial .....	53,161	100,338	(47.0)%	88,489	138,151	(35.9)%
Total retail .....	138,599	217,861	(36.4)%	181,459	248,573	(27.0)%
Gas transportation .....	4,652	3,373	37.9 %	75,572	46,905	61.1 %
Other revenues .....	486	486	-%	-	-	-%
Total .....	\$ 143,737	\$ 221,720	(35.2)%	257,031	295,478	(13.0)%
Heating degree days (normal 7,080).....				6,395	7,887	(18.9)%
Average rate per therm of retail customer . \$	0.764	\$ 0.876	(12.8)%			

Gas revenues decreased \$78.0 million or 35.2% for 2015 compared to 2014. These changes are related to the following factors:

<i>(In millions)</i>	
Volume.....	\$ (58.8)
Rate/PGA changes .....	(20.5)
Transportation and other effects .....	1.3
Total .....	\$ (78.0)

- Volume.** For 2015, retail gas deliveries decreased 27.0% compared to 2014, as a result of extremely cold weather experienced in the first quarter of 2014. The decrease was also attributable to a large commercial customer's decision to purchase gas from a third party supplier and to use MGE's facilities for the transport of that gas. While the shift affects revenues, the impact to gas income of this shift is not material as we do not earn margin on the natural gas commodity cost billed to customers.
- Rate/PGA changes.** In December 2014, the PSCW approved changes to customer rates and rate design for gas service. Rates were reduced by 2.0%, effective January 1, 2015. Gas rate design consists of a fixed monthly customer charge and a variable charge tied to actual usage, in addition to the separate charge for natural gas commodity costs that is recovered through the PGA. The change shifted more of the rate recovery to the monthly charge, reflecting the related fixed costs of providing gas services, and reduced the variable usage-based charge. Thus, gas net income was more evenly distributed during the year and less sensitive to weather.

MGE recovers the cost of natural gas in its gas segment through the purchased gas adjustment clause (PGA). Under the PGA, MGE is able to pass through to its gas customers the cost of gas. Changes in PGA recoveries affect revenues but do not impact net income.

The average retail rate per therm for 2015 decreased 12.8% compared to 2014, reflecting a \$28.7 million decrease in natural gas commodity costs (PGA) offset by an \$8.2 million increase (comprised of a decrease in variable rate costs offset by an increase in fixed rate charges) related to rate design changes. As noted previously, as a result of the rate design changes, revenues in the first and fourth quarters, when usage is higher, were lower than in past years; and revenues in the second and third quarters, when usage is lower, were higher than in past years.

- Transportation and other effects.** During 2015, transportation and other effects increased \$1.3 million primarily attributable to a large commercial customer's decision to purchase gas from a third party supplier and to use MGE's facilities for the transport of that gas. The impact to gas income of this shift is not material.

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

For 2015, cost of gas sold decreased by \$67.5 million compared to 2014. The volume of gas purchased decreased 26.8%, which resulted in \$38.5 million of decreased expense. The cost per therm of natural gas decreased 27.6%, which resulted in \$29.0 million of decreased expense.

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

Gas operating and maintenance expenses decreased \$1.2 million for 2015 compared to 2014. The following changes contributed to the net change.

<i>(In millions)</i>	
Decreased customer service costs.....	\$ (1.0)
Decreased customer accounts costs .....	(0.9)
Increased administrative and general costs .....	0.7
Total .....	<u>\$ (1.2)</u>

For 2015, decreased customer service costs are due to lower Focus on Energy payments, Wisconsin's statewide energy efficiency and renewable resource program to promote energy efficiency on customer's premises. Decreased customer accounts costs are due to lower uncollectible accounts receivable. Increased administrative and general costs are primarily due to increased pension and other postretirement benefit costs predominantly driven by a reduction in the discount rate.

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

For 2015 and 2014, net income at the nonregulated energy operations segment was \$20.1 million and \$19.3 million, respectively. The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power Elm Road (the Elm Road Units) and MGE Power West Campus (WCCF), which have been formed to own and lease electric generating capacity to assist MGE.

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

#### ***Transmission investment other income***

For 2015 and 2014, other income at the transmission investment segment was \$7.7 million and \$9.2 million, respectively. The transmission investment segment holds our interest in ATC, and its income reflects our equity in the earnings of ATC. See Footnote 4.b. of the Notes to Consolidated Financial Statements and "Other Matters" below for additional information concerning ATC and summarized financial information regarding ATC.

### **All Other Operations - MGE Energy and MGE**

#### ***Other income***

The increase in all other income primarily results from a decrease in voluntary contributions.

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

Both MGE Energy's and MGE's effective income tax rate for 2015 and 2014, was 36.7% and 37.5%, respectively. The decrease in the effective tax rate is due in part to a higher estimated domestic manufacturing deduction, offset by lower AFUDC equity earnings in 2015. See Footnote 12 of the Notes to Consolidated Financial Statements for details of effective income tax rates for continuing operations.

### **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 with respect to MGE 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, which holds our investment in ATC. The following table shows MGE Energy's noncontrolling interest, net of tax, reflected on MGE's consolidated statements of income:

<i>(In millions)</i>	Year Ended December 31,	
	2015	2014
MGE Power Elm Road .....	\$ 16.6	\$ 16.2
MGE Power West Campus .....	\$ 7.3	\$ 7.7
MGE Transco .....	\$ 2.2	\$ 2.4

### ***Liquidity and Capital Resources***

MGE Energy and MGE have adequate liquidity to fund operations and capital expenditures over the next twelve months. Available resources include cash and cash equivalents, operating cash flows, liquid assets, borrowing capacity under revolving credit facilities, and access to equity and debt capital markets.

#### **Cash Flows**

The following summarizes cash flows for MGE Energy and MGE during 2016, 2015, and 2014:

<i>(In thousands)</i>	MGE Energy			MGE		
	2016	2015	2014	2016	2015	2014
<b>Cash provided by/(used for):</b>						
Operating activities .....	\$ 147,513	\$ 141,185	\$ 128,762	\$ 146,501	\$ 148,460	\$ 128,538
Investing activities .....	(86,826)	(73,313)	(96,158)	(85,648)	(72,920)	(95,597)
Financing activities .....	(46,112)	(52,243)	(35,662)	(76,845)	(53,342)	(43,187)

#### **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.

##### *2016 vs. 2015*

Cash provided by operating activities for 2016 was \$147.5 million, an increase of \$6.3 million when compared to the prior year.

MGE Energy's net income increased \$4.2 million for 2016 when compared to the prior year.

In both 2016 and 2015, MGE received a \$10.0 million refund from the IRS for the 2015 and 2014 tax years, respectively. Excluding the 2016 and 2015 refund, MGE Energy's federal and state taxes paid decreased \$1.8 million during 2016, when compared to the prior year.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$5.2 million in cash provided by operating activities for 2016, primarily due to increased accounts payable, decreased inventories, and decreased receivable margin, partially offset by increased unbilled revenues, increased receivables, and decreased current liabilities. The decrease in current liabilities includes a fuel credit, approved in August 2015, of \$8.3 million that customers received on their bill throughout 2016 and a one-time fuel credit, approved in July 2016, of \$15.5 million that customers received on their bill in September 2016.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$5.0 million in cash provided by operating activities for 2015, primarily due to decreased receivables and decreased unbilled revenues, partially offset by increased inventories, decreased accounts payable, and decreased current liabilities. The decrease in current liabilities includes a fuel credit of \$2.6 million that customers received on their bill in the period September through December 2015 related to the 2015 fuel savings and \$11.4 million of deferred fuel related cost savings to be returned to customers.

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*2015 vs. 2014*

Cash provided by operating activities for 2015 was \$141.2 million, an increase of \$12.4 million when compared to 2014.

MGE Energy's net income decreased \$9.0 million for 2015 when compared to 2014.

In 2015, MGE received a \$10.0 million refund from the IRS for the 2014 tax year. Excluding the 2015 refund, MGE Energy's federal and state taxes paid increased \$4.7 million during 2015 when compared to 2014. In December 2014, bonus depreciation was extended for 2014. Tax payments were made earlier in 2014 before the additional depreciation deduction was known.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$5.0 million in cash provided by operating activities for 2015, primarily due to decreased receivables and decreased unbilled revenues, partially offset by increased inventories, decreased accounts payable, and decreased current liabilities. The decrease in current liabilities includes a fuel credit of \$2.6 million that customers received on their bill in the period September through December 2015 related to the 2015 fuel savings and \$11.4 million of deferred fuel related cost savings to be returned to customers.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$14.8 million in cash used for operating activities for 2014, primarily due to increased gas inventories, increased other current assets, and decreased current liabilities, partially offset by increased accounts payable. The decrease in current liabilities includes a fuel credit of \$6.5 million that customers received on their bill in October 2014 related to the 2013 fuel savings.

An increase in pension contribution resulted in an additional \$10.4 million in cash used for operating activities for 2015 when compared to 2014. Pension contributions reflect amounts required by law and discretionary amounts. See Footnote 13 of the Notes to Consolidated Financial Statements for further discussion of MGE Energy's pension and other postretirement benefits.

***MGE***

*2016 vs. 2015*

Cash provided by operating activities for 2016 was \$146.5 million, a decrease of \$2.0 million when compared to the prior year.

Net income increased \$3.1 million for 2016, when compared to the prior year.

In both 2016 and 2015, MGE received a \$10.0 million refund from the IRS for the 2015 and 2014 tax years, respectively. Excluding the 2016 and 2015 refund, MGE's federal and state taxes paid to MGE Energy increased \$4.2 million during 2016, when compared to the prior year.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$7.4 million in cash provided by operating activities for 2016, primarily due to increased accounts payable, decreased inventories, and decreased receivable margin, partially offset by increased receivables, increased unbilled revenues, and decreased current liabilities. The decrease in current liabilities includes a fuel credit, that was approved in August 2015, of \$8.3 million that customers received on their bill throughout 2016 and \$15.5 million of deferred fuel related cost savings to be returned to customers.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$14.0 million in cash provided by operating activities for 2015, primarily due to decreased receivables and decreased unbilled revenues, partially offset by increased gas inventories, decreased accounts payable, and decreased other current liabilities. The decrease in current liabilities includes a fuel credit of \$2.6 million that customers received on their bill in the period September through December 2015 related to the 2015 fuel savings and \$11.4 million of deferred fuel related cost savings to be returned to customers.

*2015 vs. 2014*

Cash provided by operating activities for 2015 was \$148.5 million, an increase of \$19.9 million when compared to 2014.

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Net income decreased \$10.5 million for 2015 when compared to 2014.

In 2015, MGE received a \$10.0 million refund from the IRS for the 2014 tax year. Excluding the 2015 refund, MGE's federal and state taxes paid to MGE Energy decreased \$3.3 million during 2015, when compared to the prior year. In December 2014, bonus depreciation was extended for 2014. Tax payments were made earlier in 2014 before the additional depreciation deduction was known.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$14.0 million in cash provided by operating activities for 2015, primarily due to decreased receivables and decreased unbilled revenues, partially offset by increased gas inventories, decreased accounts payable, and decreased other current liabilities. The decrease in current liabilities includes a fuel credit of \$2.6 million that customers received on their bill in the period September through December 2015 related to the 2015 fuel savings and \$11.4 million of deferred fuel related cost savings to be returned to customers.

Working capital accounts (excluding prepaid and accrued taxes) resulted in \$20.9 million in cash used for operating activities for 2014, primarily due to increased gas inventories, increased receivables, and decreased current liabilities, partially offset by increased accounts payable. The decrease in current liabilities includes a fuel credit of \$6.5 million that customers received on their bill in October 2014 related to the 2013 fuel savings.

An increase in pension contribution resulted in an additional \$10.4 million in cash used for operating activities for 2015 when compared to 2014. These contributions reflect amounts required by law and discretionary amounts. See Footnote 13 of the Notes to Consolidated Financial Statements for further discussion of MGE's pension and other postretirement benefits.

## **Capital Requirements and Investing Activities**

### ***MGE Energy***

#### *2016 vs. 2015*

MGE Energy's cash used for investing activities increased \$13.5 million for 2016 when compared to the prior year.

Capital expenditures for 2016 were \$83.7 million. This amount represents an increase of \$11.6 million from the expenditures made in the prior year. This increase primarily reflects increased expenditures on electric and gas distribution assets.

There was a \$1.9 million increase in the capital contributions to investments for 2016 when compared to the prior year.

#### *2015 vs. 2014*

MGE Energy's cash used for investing activities decreased \$22.8 million for 2015 when compared to 2014.

Capital expenditures for 2015 were \$72.0 million. This amount represents a decrease of \$20.6 million from the expenditures made in 2014. The decrease primarily reflects \$16.2 million of lower expenditures on the Columbia environmental project in 2015 versus 2014 and decreased expenditures in electric and gas distribution assets.

### ***MGE***

#### *2016 vs. 2015*

MGE's cash used for investing activities increased \$12.7 million for 2016 when compared to the prior year.

Capital expenditures for 2016 were \$83.7 million. This amount represents an increase of \$11.6 million from the expenditures made in the prior year. This increase primarily reflects increased expenditures on electric and gas distribution assets.

There was a \$0.9 million increase in the capital contributions to investments for 2016 when compared to the prior year.

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2015 vs. 2014

MGE's cash used for investing activities decreased \$22.7 million for 2015 when compared to 2014.

Capital expenditures for 2015 were \$72.0 million. This amount represents a decrease of \$20.6 million from the expenditures made in 2014. The decrease primarily reflects \$16.2 million of lower expenditures on the Columbia environmental project in 2015 versus 2014 and decreased expenditures in electric and gas distribution assets.

**Capital expenditures**

The following table shows MGE Energy's actual capital expenditures for both 2016 and 2015, forecasted capital expenditures for 2017, and annual average forecasted capital expenditures for the years 2018 through 2020:

<i>(In thousands)</i>	Actual		Forecasted	
	2015	2016	2017	(Annual Average) 2018-2020
<b>For the years ended December 31,</b>				
Electric.....	\$ 49,370	\$ 50,699	\$ 72,603	\$ 78,768
Gas .....	18,787	29,136	34,197	35,475
Utility plant total.....	68,157	79,835	106,800	114,243
Nonregulated .....	3,873	3,824	7,362	4,959
MGE Energy total.....	\$ 72,030	\$ 83,659	\$ 114,162	\$ 119,202

The forecasted capital expenditures are based upon management's assumptions with respect to future events, including the timing and amount of expenditures associated with compliance with environmental compliance initiatives, load growth, and the timing and adequacy of rate recovery. Actual events may differ materially from those assumptions and result in material changes to those forecasted amounts.

MGE Energy used funds received as dividend payments from MGE Power West Campus and MGE Power Elm Road, internally generated cash, and short-term external financing to meet its 2016 capital requirements and cash obligations, including dividend payments. External financing included short-term financing under existing lines of credit.

**Financing Activities**

**MGE Energy**

2016 vs. 2015

Cash used for MGE Energy's financing activities was \$46.1 million for 2016, compared to \$52.2 million of cash used for 2015.

For 2016, cash dividends paid were \$41.8 million compared to \$40.0 million in the prior year. This increase was a result of a higher dividend per share (\$1.21 vs. \$1.16).

For 2015, net short-term debt repayments were \$7.0 million. There were no short-term debt repayments for 2016.

2015 vs. 2014

Cash used for MGE Energy's financing activities was \$52.2 million for 2015, compared to \$35.7 million of cash used for 2014.

For 2015, cash dividends paid were \$40.0 million compared to \$38.4 million in 2014. This increase was a result of a higher dividend per share (\$1.16 vs. \$1.11).

For 2015, net short-term debt repayments were \$7.0 million. There were no short-term debt repayments for 2014.



Borrowings under the Credit Agreements may bear interest at a rate based upon either a "floating rate" or a "Eurodollar Rate" adjusted for statutory reserve requirements, plus an adder based upon the credit ratings assigned to MGE's senior unsecured long-term debt securities. The "floating rate" is calculated on a daily basis as the highest of a prime rate, a Federal Funds effective rate plus 0.5% per annum, or a Eurodollar Rate for a one-month interest period plus 1%. The "floating rate" adder ranges from zero to 0.125%. The "Eurodollar Rate" is calculated as provided in the Credit Agreements. The "Eurodollar Rate" adder ranges from 0.625% to 1.125%.

The agreements require the borrower to maintain a ratio of consolidated debt to consolidated total capitalization not to exceed a maximum of 65%. The ratio calculation excludes assets, liabilities, revenues, and expenses included in MGE's financial statements as a result of the consolidation of VIEs, such as MGE Power Elm Road and MGE Power West Campus. At December 31, 2016, the ratio of consolidated debt to consolidated total capitalization for each of MGE Energy and MGE, as calculated under the credit agreements' covenant, were 34.8% and 36.5%, respectively. See Footnote 10 of the Notes to Consolidated Financial Statements for additional information regarding the credit facilities.

### Capitalization Ratios

MGE Energy's capitalization ratios were as follows:

	MGE Energy	
	2016	2015
Common shareholders' equity.....	65.2 %	63.8 %
Long-term debt* .....	34.8 %	36.2 %

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

### 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.

### Contractual Obligations and Commercial Commitments for MGE Energy and MGE

MGE Energy's and MGE's contractual obligations as of December 31, 2016, representing cash obligations that are considered to be firm commitments, are as follows:

(In thousands)	Total	Payment Due Within:			Due After 5 Years
		1 Year	2-3 Years	4-5 Years	
<b>MGE Energy</b>					
Long-term debt <sup>(a)</sup> .....	\$ 391,242	\$ 4,358	\$ 29,005	\$ 24,430	\$ 333,449
Repurchase-to-maturity transactions - loans <sup>(b)</sup> .....	3,895	559	1,215	1,000	1,121
Interest expense <sup>(c)</sup> .....	258,164	17,659	33,052	30,803	176,650
Operating leases <sup>(d)</sup> .....	11,339	1,331	1,400	588	8,020
Purchase obligations <sup>(e)</sup> .....	444,792	122,846	142,872	89,512	89,562
Other obligations <sup>(f)</sup> .....	30,445	20,569	2,835	1,395	5,646
Total MGE Energy contractual obligations .....	<u>\$ 1,139,877</u>	<u>\$ 167,322</u>	<u>\$ 210,379</u>	<u>\$ 147,728</u>	<u>\$ 614,448</u>
<b>MGE</b>					
Long-term debt <sup>(a)</sup> .....	\$ 391,242	\$ 4,358	\$ 29,005	\$ 24,430	\$ 333,449
Repurchase-to-maturity transactions - loans <sup>(b)</sup> .....	3,895	559	1,215	1,000	1,121
Interest expense <sup>(c)</sup> .....	258,164	17,659	33,052	30,803	176,650
Operating leases <sup>(d)</sup> .....	11,339	1,331	1,400	588	8,020
Purchase obligations <sup>(e)</sup> .....	444,792	122,846	142,872	89,512	89,562
Other obligations <sup>(f)</sup> .....	18,613	8,737	2,835	1,395	5,646
Total MGE contractual obligations .....	<u>\$ 1,128,045</u>	<u>\$ 155,490</u>	<u>\$ 210,379</u>	<u>\$ 147,728</u>	<u>\$ 614,448</u>

- (a) Long-term debt consisting of secured first mortgage bonds, unsecured medium-term notes, and Industrial Development Revenue Bonds issued by MGE, and private placement debt issued by MGE, MGE Power Elm Road, and MGE Power West Campus.
- (b) Chattel paper agreements. See Footnote 1.g. of the Notes to Consolidated Financial Statements.
- (c) Amount represents interest expense on long-term debt. See Footnote 9 of the Notes to Consolidated Financial Statements for further discussion of the long-term debt outstanding at December 31, 2016.
- (d) Operating leases. See Footnote 17.b. of the Notes to Consolidated Financial Statements.
- (e) Purchase obligations for MGE Energy and MGE consist primarily of the purchase of electricity and natural gas, electric transmission, natural gas storage capacity, natural gas pipeline transportation, and the purchase and transport of coal. See Footnote 17.a. of the Notes to Consolidated Financial Statements.
- (f) Other obligations are primarily related to investment commitments, easements, environmental projects, fuel credit, and uncertain tax positions.

The above amounts do not include any contributions for MGE's pension and postretirement plans. Voluntary contributions to the qualified plans for 2017 were \$6.0 million, which were paid in January 2017. MGE does not expect to make contributions to the plans for 2018. The contributions for years after 2018 are not yet currently estimated. Due to uncertainties in the future economic performance of plan assets, discount rates, and other key assumptions, estimated contributions are subject to change. MGE may also elect to make additional discretionary contributions to the plans.

The above amounts do not include future capital calls by ATC and ATC Holdco. On January 31, 2017, MGE Transco made a \$1.4 million capital contribution to ATC, and on January 10, 2017, MGEE Transco made a \$0.2 million capital contribution to ATC Holdco. The amount and timing of future capital calls is uncertain and primarily dependent on the operations and expansion of ATC and ATC Holdco.

MGE Energy's and MGE's commercial commitments as of December 31, 2016, representing commitments triggered by future events and including financing arrangements to secure obligations of MGE Energy and MGE, are as follows:

<i>(In thousands)</i>	Total	Expiration Within:			Due After 5 Years
		1 Year	2-3 Years	4-5 Years	
<b>MGE Energy</b>					
Available lines of credit <sup>(a)</sup> .....	\$ 150,000	\$ -	\$ -	\$ 150,000	\$ -
<b>MGE</b>					
Available lines of credit <sup>(b)</sup> .....	\$ 100,000	\$ -	\$ -	\$ 100,000	\$ -

- (a) Amount includes the facility discussed in (b) plus an additional line of credit. MGE Energy has available at any time a \$50 million committed revolving credit agreement, expiring in June 2020. At December 31, 2016, MGE Energy had no borrowings outstanding under this credit facility.
- (b) Amount includes two committed revolving credit agreements totaling \$100 million expiring in June 2020. These credit facilities are used to support commercial paper issuances. At December 31, 2016, MGE had no borrowings outstanding under these facilities, and MGE had no commercial paper outstanding.

### ***Other Matters***

#### **ATC**

In 2013, several parties filed the first complaint with the FERC seeking to reduce the base return on equity (ROE) used by MISO transmission owners, including ATC, "due to changes in the capital markets." The complaint alleged that the MISO ROE should not exceed 9.15%, the equity components of hypothetical capital structures should be restricted to 50%, and the relevant incentive ROE adders should be discontinued. At the time, MISO's base ROE was 12.38% and ATC's base ROE was 12.2%. In February 2015, a second complaint was filed for the period February 2015 through May 2015 with the FERC requesting a reduction in the base ROE used by MISO

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transmission owners, including ATC, to 8.67%, with a refund effective date retroactive to the filing date of the complaint. In June 2016, an administrative law judge issued an initial decision for the second complaint that would reduce the transmission owner's base ROE to 9.7%. The initial decision will be reviewed by FERC. It is anticipated FERC will issue an order on this issue by mid-2017. On September 28, 2016, FERC issued an order on the first complaint, for the period November 2013 through February 2015, reducing the base ROE to 10.32%. This base ROE also became effective September 28, 2016, and will apply to future periods until FERC rules in the second complaint, at which time the base ROE ordered by FERC in the second complaint will prospectively become the authorized base ROE.

In January 2015, FERC accepted the transmission owner's request for a 50 basis-point incentive ROE adder for participating in MISO. The adder became effective January 6, 2015, subject to refund, and FERC accepted the transmission owner's request to defer collection of the adder pending the outcome of the first ROE complaint proceeding.

Any change to ATC's ROE could result in lower equity earnings and distributions from ATC in the future. Our share of ATC's earnings reflects a pre-tax charge of \$1.9 million and \$2.3 million for 2016 and 2015, respectively, recorded by ATC for this matter representing its estimate of its refund liability. We derived approximately 6.8% and 6.4% of our net income for 2016 and 2015, respectively, from our investment in ATC.

### ***Critical Accounting Estimates - MGE Energy and MGE***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to unbilled revenues, allowance for doubtful accounts, pension obligations, income taxes, derivatives, and regulatory assets and liabilities. We base our estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Those values may differ from these estimates under different assumptions or conditions. We believe the following critical accounting estimates affect our more significant judgments used in the preparation of our consolidated financial statements.

#### **Unbilled Revenues**

Revenues from the sale of electricity and gas to customers are recorded when electricity/gas is delivered to those customers. The quantity of those sales is measured by customers' meters. Due to the large volume of those meters, it is impractical to read all of them at month end. Meters are read on a systematic basis throughout the month based on established meter-reading schedules. Consequently, at the end of any month, there exists a quantity of electricity and gas that has been delivered to customers but has not been captured by the meter readings. As a result, management must estimate revenue related to electricity and gas delivered to customers between their meter-read dates and the end of the period. These estimates include:

- The amount of electricity expected to be lost in the process of its transmission and distribution to customers (line loss) and the amount of electricity actually delivered to customers.
- The amount of gas expected to be lost in the process of its distribution to customers and the amount of gas actually delivered to customers.
- The mix of sales between customer rate classes, which is based upon historical utilization assumptions.

MGE monitors the reasonableness of the unbilled revenue estimate through the review of ratios such as unbilled electric consumption compared to billed electric sales. In the case of unbilled gas, the estimated unbilled consumption is compared to various other statistics, including percent of gas available for sale, change in unbilled month to month and change in unbilled compared to the prior year in order to confirm its reasonableness.

#### **Allowance for Doubtful Accounts**

MGE maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. It determines the allowance based on historical write-off experience, regional economic data, and review of the accounts receivable aging. MGE reviews its allowance for doubtful accounts monthly.

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Although management believes that the allowance for doubtful accounts is MGE's best estimate of the amount of probable credit losses, if the financial condition of MGE's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

### **Pension and Other Postretirement Benefit Plans**

MGE provides employees with certain retirement (pension) and postretirement (health care and life insurance) benefits. In order to measure the expense and obligations associated with these benefits, management must make a variety of estimates, including discount rates used to value certain liabilities, the expected return on plan assets set aside to fund these costs, the rate of compensation increase, employee turnover rates, retirement rates, health care trends, mortality rates, and other factors. These accounting estimates bear the risk of change due to the uncertainty attached to the estimate as well as the fact that these estimates are difficult to measure. Different estimates used by us could result in recognizing different amounts of expense over different periods of time and recovery in rates is expected.

We use third-party specialists to assist us in evaluating our assumptions as well as appropriately measure the costs and obligations associated with these retirement benefits. The discount rate and expected return on plan assets are based primarily on available investment yields and the historical performance of our plan assets. They are critical accounting estimates because they are subject to management's judgment and can materially affect net income.

- *Assumed return on assets.* This assumption represents the rate of return on plan assets reflecting the average rate of earnings expected on the funds invested (or to be invested) to provide for the benefits included in the projected benefit obligation. For 2016, MGE used an assumed return on assets of 7.65% for pension and 6.96% for other postretirement benefits. In 2017, the pension asset assumption will decrease from 7.65% to 7.40%. MGE will decrease the postretirement benefit assumption from 6.96% to 6.78% in 2017. The annual expected rate of return is based on projected long-term equity and bond returns, maturities and asset allocations. Holding other assumptions constant, for every 1% reduction in the expected rate of return on plan assets, annual pension and other postretirement cost would increase by approximately \$3.3 million, before taxes.
- *Discount rate.* The discount rate represents the rate at which pension obligations could effectively be settled on a present-value basis. MGE uses high-grade bond yields as a benchmark for determining the appropriate discount rate. At December 31, 2015, MGE refined its methodology for using discount rates to measure the components of net periodic benefit cost. The refined methodology uses individual spot rates, instead of a weighted average of the yield curve spot rates, for measuring the service cost and interest cost components. Holding other assumptions constant, a 0.5% reduction in the discount rate on the obligation balance at December 31, 2016, would increase annual pension and other postretirement cost by approximately \$2.8 million, before taxes.
- *Medical trend assumptions.* The health care cost trend rate is the assumed rate of increase in per-capita health care charges.
- *Mortality rate assumption.* Expected mortality rates are used in the valuation to determine the expected duration of future benefit payments to the plan participants. In 2016, the Society of Actuaries released new mortality tables and projection scales. At December 31, 2016, the Company adopted a modified version of these tables that were developed by a third party actuary.

See Footnote 13 of the Notes to Consolidated Financial Statements for additional discussion of these plans.

### **Income Tax Provision**

MGE Energy's and MGE's income tax provisions, including both current and deferred components, are based on estimates, assumptions, calculations, and interpretation of tax statutes for the current and future years. Determination of current-year federal and state income tax will not be settled for years.

Management regularly makes assessments of tax return outcomes relative to financial statement tax provisions and adjusts the tax provisions in the period when facts become final.

Additionally, in determining our current income tax provision, we assess temporary differences resulting from differing treatments of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded in our balance sheets. When we maintain deferred tax assets, we assess the likelihood that these assets will be recovered through adjustments to future taxable income. To the extent we believe recovery

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is not more likely than not, we establish a valuation allowance. We record an allowance reducing the asset to a value we believe will be recoverable based on our expectation of future taxable income. We believe the accounting estimate related to the valuation allowance is a critical accounting estimate because it is highly susceptible to change from period to period as it requires management to make assumptions about our future income over the lives of the deferred tax assets, and the impact of increasing or decreasing the valuation allowance is potentially material to our results of operations.

Accounting for uncertainty in income taxes applies to all tax positions and requires a recognition threshold and measurement standard for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in an income tax return. The threshold is defined for recognizing tax return positions in the financial statements as "more likely than not" that the position is sustainable, based on its merits. Subsequent recognition, derecognition, and measurement is based on management's best judgment given the facts, circumstances and information available at the reporting date.

### **Accounting for Derivative Instruments**

MGE accounts for derivative financial instruments, except those qualifying for the normal purchase normal sale exception, at their fair value on the balance sheet. Fair value is determined using current quoted market prices, except for the PPA, which is valued utilizing an internally-developed pricing model. This model includes observable and unobservable inputs.

MGE received approval from the PSCW to establish a regulatory asset or liability for the deferral of the effects of mark-to-market accounting on contracts related to commodity hedging in MGE's regulated operations.

### **Regulatory Assets/Liabilities**

Regulatory assets represent costs that have been deferred to future periods when it is probable that the regulator will allow future recovery of those costs through rates. MGE bases its assessment of recovery on precedents established by the regulatory body. Regulatory liabilities represent previous collections from customers that are expected to be refunded to customers in future periods. Regulatory assets and regulatory liabilities typically include deferral of energy costs, the normalization of income taxes, the deferral of certain operating expenses, and non-ARO removal costs. The accounting for these regulatory assets and liabilities is in accordance with regulatory accounting standards.

MGE continually assesses whether the regulatory assets and liabilities meet the criteria for probability of future recovery or deferral. This assessment considers factors such as changes in the regulatory environment, recent rate orders to other regulated entities under the same jurisdiction, and the status of any pending or potential deregulation legislation. If future recovery of costs becomes no longer probable, the assets and liabilities would be recognized as current-period revenues or expenses.

Amortization of regulatory assets and liabilities is provided over the recovery or deferral period as allowed in the related regulatory agreement.

### **Adoption of Accounting Principles and Recently Issued Accounting Pronouncements - MGE Energy and MGE**

See Footnote 19 of the Notes to Consolidated Financial Statements for discussion of new accounting pronouncements.

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## **Item 7A. 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'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 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. The fuel rules require the PSCW and Wisconsin utilities to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band. Any over/under recovery of the actual costs in a year is determined in the following year and is then reflected in future billings to electric retail customers. Under the electric fuel rules, MGE is required to defer the benefit of lower costs if the actual electric fuel costs fall outside the lower end of the range and is required to defer costs, less any excess revenues, if the actual electric fuel costs exceed 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 2017, fuel and purchased power costs included in MGE's base fuel rates are \$101.9 million. See Footnote 16 of the Notes to Consolidated Financial Statements for additional information.

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

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

MGE has financial gas and electric commodity contracts to hedge commodity price risk in the gas and electric utility 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 December 31, 2016, the fair value of these instruments exceeded their cost basis by \$1.3 million. Under the PGA clause and electric fuel rules, MGE may include in the costs of fuel (natural gas or power) the costs and benefits of the aforementioned fuel price risk management tools. Because these costs/benefits are recoverable, the related unrealized loss/gain has been deferred on the consolidated balance sheets as a regulatory asset/liability.

MGE has also entered into a 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 an option to extend the contract after the base term. The agreement is considered a derivative contract and is recognized at its fair value on the consolidated balance sheet. However, the derivative qualifies for regulatory deferral and is recognized with a corresponding regulatory asset or liability depending on whether the fair value is in a loss or gain position. The fair value of the contract at December 31, 2016, reflects a loss position of \$50.6 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.

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### **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. Holding other assumptions constant, for every 1% reduction in the expected rate of return on plan assets, annual pension and other postretirement cost would increase by approximately \$3.3 million, before taxes. MGE's risk of expense and annuity payments, as a result of changes in the market value of the trust funds, is mitigated in part through future rate actions by the PSCW. The value of employee benefit plans trusts' assets have increased in value by approximately 8.36% and 1.39% during the years ended December 31, 2016, and 2015, respectively.

### **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 December 31, 2016, 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 1,682 square miles in Wisconsin. Based on results for December 31, 2016, no one customer constituted more than 10% of total operating revenues for MGE Energy and MGE. Credit risk for electric and gas is managed by MGE's credit and collection policies, which are consistent with state regulatory requirements.

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

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## **Item 8. Financial Statements and Supplementary Data.**

### **MGE Energy**

#### ***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an assessment of the effectiveness of our internal control over financial reporting based on the framework in the Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment under the framework in the Internal Control - Integrated Framework (2013), our management concluded that our internal control over financial reporting was effective as of December 31, 2016.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The effectiveness of MGE Energy's internal control over financial reporting as of December 31, 2016, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

February 24, 2017

### **MGE**

#### ***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an assessment of the effectiveness of our internal control over financial reporting based on the framework in the Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment under the framework in the Internal Control - Integrated Framework (2013), our management concluded that our internal control over financial reporting was effective as of December 31, 2016.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

February 24, 2017

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## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of MGE Energy, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of MGE Energy, Inc. and its subsidiaries at December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Chicago, Illinois

February 24, 2017

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## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholder of Madison Gas and Electric Company:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Madison Gas and Electric Company and its subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP  
Chicago, Illinois  
February 24, 2017

**MGE Energy, Inc.**  
**Consolidated Statements of Income**  
*(In thousands, except per share amounts)*

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Operating Revenues:</b>			
Electric revenues.....	\$ 410,202	\$ 420,291	\$ 398,132
Gas revenues .....	134,543	143,737	221,720
<i>Total Operating Revenues</i> .....	<u>544,745</u>	<u>564,028</u>	<u>619,852</u>
<b>Operating Expenses:</b>			
Fuel for electric generation.....	60,736	53,858	42,828
Purchased power .....	56,313	81,224	73,232
Cost of gas sold .....	66,771	76,109	143,644
Other operations and maintenance .....	167,989	164,478	161,703
Depreciation and amortization .....	44,646	44,225	40,695
Other general taxes.....	20,062	19,879	19,652
<i>Total Operating Expenses</i> .....	<u>416,517</u>	<u>439,773</u>	<u>481,754</u>
<b>Operating Income</b> .....	<u>128,228</u>	<u>124,255</u>	<u>138,098</u>
Other income, net .....	9,711	8,613	10,079
Interest expense, net.....	(19,866)	(20,162)	(19,673)
Income before income taxes .....	118,073	112,706	128,504
Income tax provision.....	(42,513)	(41,363)	(48,185)
<b>Net Income</b> .....	<u>\$ 75,560</u>	<u>\$ 71,343</u>	<u>\$ 80,319</u>
<b>Earnings Per Share of Common Stock</b>			
(basic and diluted) .....	<u>\$ 2.18</u>	<u>\$ 2.06</u>	<u>\$ 2.32</u>
Dividends per share of common stock.....	<u>\$ 1.21</u>	<u>\$ 1.16</u>	<u>\$ 1.11</u>
<b>Weighted Average Shares Outstanding</b>			
(basic and diluted) .....	34,668	34,668	34,668

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

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

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net Income .....	\$ 75,560	\$ 71,343	\$ 80,319
Other comprehensive income, net of tax:			
Unrealized (loss) gain on available-for-sale securities, net of tax (\$104, \$67, and (\$54)).....	(155)	(101)	81
<b>Comprehensive Income</b> .....	<u>\$ 75,405</u>	<u>\$ 71,242</u>	<u>\$ 80,400</u>

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

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

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Operating Activities:</b>			
Net income.....	\$ 75,560	\$ 71,343	\$ 80,319
Items not affecting cash:			
Depreciation and amortization .....	44,646	44,225	40,695
Deferred income taxes .....	22,421	21,927	49,884
Provision for doubtful receivables .....	1,196	596	1,898
Employee benefit plan expenses.....	295	3,333	(1,080)
Equity earnings in ATC.....	(8,428)	(7,728)	(9,150)
Other items .....	1,426	721	729
Changes in working capital items:			
Trade and other receivables .....	(5,666)	4,508	2,115
Inventories.....	7,273	(2,646)	(10,399)
Unbilled revenues.....	(4,838)	6,254	720
Prepaid taxes.....	8,616	3,658	(19,804)
Other current assets .....	700	978	(5,693)
Accounts payable .....	9,881	(3,499)	2,756
Other current liabilities .....	(1,738)	(597)	(4,195)
Dividend income from ATC.....	7,926	6,645	7,740
Cash contributions to pension and other postretirement plans.....	(14,452)	(13,676)	(3,321)
Other noncurrent items, net .....	2,695	5,143	(4,452)
<i>Cash Provided by Operating Activities</i> .....	<u>147,513</u>	<u>141,185</u>	<u>128,762</u>
<b>Investing Activities:</b>			
Capital expenditures .....	(83,659)	(72,030)	(92,676)
Capital contributions to investments.....	(2,958)	(1,053)	(2,185)
Other .....	(209)	(230)	(1,297)
<i>Cash Used for Investing Activities</i> .....	<u>(86,826)</u>	<u>(73,313)</u>	<u>(96,158)</u>
<b>Financing Activities:</b>			
Cash dividends paid on common stock .....	(41,775)	(40,043)	(38,429)
Repayment of long-term debt .....	(4,267)	(4,182)	(4,103)
(Decrease) increase in short-term debt.....	-	(7,000)	7,000
Other .....	(70)	(1,018)	(130)
<i>Cash Used for Financing Activities</i> .....	<u>(46,112)</u>	<u>(52,243)</u>	<u>(35,662)</u>
Change in cash and cash equivalents: .....	14,575	15,629	(3,058)
Cash and cash equivalents at beginning of period .....	81,384	65,755	68,813
<b>Cash and cash equivalents at end of period</b> .....	<u>\$ 95,959</u>	<u>\$ 81,384</u>	<u>\$ 65,755</u>
<b>Supplemental Disclosures of Cash Flow Information:</b>			
Interest paid.....	\$ 19,415	\$ 19,636	\$ 20,478
Income taxes paid .....	\$ 21,831	\$ 23,800	\$ 19,579
Income taxes received .....	\$ (10,000)	\$ (10,130)	\$ (644)
Significant noncash investing activities:			
Accrued capital expenditures .....	\$ 16,376	\$ 3,963	\$ 1,569

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

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

	<b>At December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents .....	\$ 95,959	\$ 81,384
Accounts receivable, less reserves of \$3,017 and \$3,052, respectively .....	39,887	37,112
Other accounts receivable, less reserves of \$426 and \$642, respectively.....	8,530	7,477
Unbilled revenues .....	29,846	25,008
Materials and supplies, at average cost .....	18,561	19,155
Fossil fuel, at average cost .....	9,757	13,110
Stored natural gas, at average cost.....	12,819	16,145
Prepaid taxes .....	26,636	35,252
Regulatory assets - current .....	6,414	9,538
Assets held for sale .....	14,813	-
Other current assets .....	12,293	10,570
<i>Total Current Assets</i> .....	<u>275,515</u>	<u>254,751</u>
Other long-term receivables .....	5,603	5,045
Regulatory assets.....	158,485	148,199
Pension and other postretirement benefit asset .....	2,020	-
Other deferred assets and other.....	1,088	1,332
<b>Property, Plant, and Equipment:</b>		
Property, plant, and equipment, net .....	1,245,269	1,217,094
Construction work in progress .....	36,790	26,351
<i>Total Property, Plant, and Equipment</i> .....	<u>1,282,059</u>	<u>1,243,445</u>
<b>Investments</b> .....	76,290	73,631
<b>Total Assets</b> .....	<u>\$ 1,801,060</u>	<u>\$ 1,726,403</u>
<b>LIABILITIES AND CAPITALIZATION</b>		
<b>Current Liabilities:</b>		
Long-term debt due within one year .....	\$ 4,333	\$ 4,266
Accounts payable .....	47,799	40,830
Accrued interest and taxes.....	5,495	5,067
Accrued payroll related items .....	11,892	11,215
Regulatory liabilities - current .....	6,910	9,515
Derivative liabilities .....	7,620	8,343
Other current liabilities .....	19,456	4,910
<i>Total Current Liabilities</i> .....	<u>103,505</u>	<u>84,146</u>
<b>Other Credits:</b>		
Deferred income taxes .....	383,813	360,785
Investment tax credit - deferred .....	947	1,050
Regulatory liabilities .....	22,173	20,785
Accrued pension and other postretirement benefits .....	74,347	75,680
Derivative liabilities .....	42,970	44,935
Other deferred liabilities and other .....	66,426	61,820
<i>Total Other Credits</i> .....	<u>590,676</u>	<u>565,055</u>
<b>Capitalization:</b>		
Common shareholders' equity:		
Common Stock - \$1 par value - 75,000 shares authorized;		
34,668 shares issued and outstanding.....	34,668	34,668
Additional paid-in capital .....	316,268	316,268
Retained earnings .....	372,950	339,165
Accumulated other comprehensive income, net of tax .....	202	357
<i>Total Common Shareholders' Equity</i> .....	<u>724,088</u>	<u>690,458</u>
Long-term debt .....	382,791	386,744
<i>Total Capitalization</i> .....	<u>1,106,879</u>	<u>1,077,202</u>
Commitments and contingencies (see Footnote 17) .....	-	-
<b>Total Liabilities and Capitalization</b> .....	<u>\$ 1,801,060</u>	<u>\$ 1,726,403</u>

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

**MGE Energy, Inc.**  
**Consolidated Statements of Common Equity**  
*(In thousands, except per share amounts)*

	Common Stock		Additional	Retained	Accumulated	
	Shares	Value	Paid-in	Earnings	Other	Total
			Capital		Comprehensive	
					Income/(Loss)	
<b>2014</b>						
Beginning balance - December 31, 2013 .....	34,668	\$ 34,668	\$ 316,268	\$ 266,197	\$ 377	\$ 617,510
Net income .....				80,319		80,319
Other comprehensive income.....					81	81
Common stock dividends declared						
(\$1.11 per share).....				(38,429)		(38,429)
Cash in lieu of fractional shares related to stock split ....				(80)		(80)
Ending balance - December 31, 2014.....	34,668	\$ 34,668	\$ 316,268	\$ 308,007	\$ 458	\$ 659,401
<b>2015</b>						
Beginning balance - January 1, 2015 .....	34,668	\$ 34,668	\$ 316,268	\$ 308,007	\$ 458	\$ 659,401
Cumulative effect of new accounting principle .....				(142)		(142)
Beginning balance - Adjusted .....				307,865		659,259
Net income .....				71,343		71,343
Other comprehensive loss .....					(101)	(101)
Common stock dividends declared						
(\$1.16 per share).....				(40,043)		(40,043)
Ending balance - December 31, 2015.....	34,668	\$ 34,668	\$ 316,268	\$ 339,165	\$ 357	\$ 690,458
<b>2016</b>						
Net income .....				75,560		75,560
Other comprehensive loss .....					(155)	(155)
Common stock dividends declared						
(\$1.21 per share).....				(41,775)		(41,775)
Ending balance - December 31, 2016.....	34,668	\$ 34,668	\$ 316,268	\$ 372,950	\$ 202	\$ 724,088

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

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

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Operating Revenues:</b>			
Electric revenues.....	\$ 410,226	\$ 420,313	\$ 398,154
Gas revenues .....	134,572	143,752	221,741
<i>Total Operating Revenues</i> .....	<u>544,798</u>	<u>564,065</u>	<u>619,895</u>
<b>Operating Expenses:</b>			
Fuel for electric generation.....	60,745	53,866	42,836
Purchased power .....	56,327	81,237	73,245
Cost of gas sold .....	66,800	76,124	143,665
Other operations and maintenance .....	167,077	163,622	160,831
Depreciation and amortization .....	44,622	44,178	40,648
Other general taxes.....	20,062	19,879	19,652
Income tax provision .....	39,616	38,159	45,090
<i>Total Operating Expenses</i> .....	<u>455,249</u>	<u>477,065</u>	<u>525,967</u>
<b>Operating Income</b> .....	<u>89,549</u>	<u>87,000</u>	<u>93,928</u>
<b>Other Income and Deductions:</b>			
AFUDC - equity funds.....	1,207	712	3,466
Equity earnings in MGE Transco .....	6,366	7,728	9,150
Income tax provision .....	(2,175)	(3,247)	(4,055)
Other deductions, net.....	(217)	(345)	(704)
<i>Total Other Income and Deductions</i> .....	<u>5,181</u>	<u>4,848</u>	<u>7,857</u>
Income before interest expense.....	<u>94,730</u>	<u>91,848</u>	<u>101,785</u>
<b>Interest Expense:</b>			
Interest on long-term debt .....	20,351	20,520	20,927
Other interest, net.....	182	94	62
AFUDC - borrowed funds.....	(395)	(231)	(1,142)
<i>Net Interest Expense</i> .....	<u>20,138</u>	<u>20,383</u>	<u>19,847</u>
<b>Net Income</b> .....	<u>\$ 74,592</u>	<u>\$ 71,465</u>	<u>\$ 81,938</u>
Less Net Income Attributable to Noncontrolling Interest, net of tax .....	<u>(23,358)</u>	<u>(26,097)</u>	<u>(26,310)</u>
<b>Net Income Attributable to MGE</b> .....	<u>\$ 51,234</u>	<u>\$ 45,368</u>	<u>\$ 55,628</u>

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

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

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net Income .....	\$ 74,592	\$ 71,465	\$ 81,938
Other comprehensive income, net of tax:			
Unrealized loss on available-for-sale securities, net of tax (\$2, \$81, and \$33).....	(4)	(121)	(48)
<b>Comprehensive Income</b> .....	<u>\$ 74,588</u>	<u>\$ 71,344</u>	<u>\$ 81,890</u>
Less: Comprehensive Income Attributable to Noncontrolling Interest, net of tax .....	<u>(23,358)</u>	<u>(26,097)</u>	<u>(26,310)</u>
<b>Comprehensive Income Attributable to MGE</b> .....	<u>\$ 51,230</u>	<u>\$ 45,247</u>	<u>\$ 55,580</u>

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

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

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Operating Activities:</b>			
Net income.....	\$ 74,592	\$ 71,465	\$ 81,938
Items not affecting cash:			
Depreciation and amortization .....	44,622	44,178	40,648
Deferred income taxes .....	20,876	18,843	49,603
Provision for doubtful receivables .....	1,196	596	1,898
Employee benefit plan expenses.....	295	3,333	(1,080)
Equity earnings in MGE Transco .....	(6,366)	(7,728)	(9,150)
Other items .....	1,954	1,223	1,280
Changes in working capital items:			
Trade and other receivables .....	(3,583)	11,079	(4,455)
Inventories.....	7,273	(2,647)	(10,398)
Unbilled revenues.....	(4,838)	6,254	720
Prepaid taxes.....	8,481	4,824	(15,169)
Other current assets .....	699	976	(5,693)
Accounts payable .....	9,941	(3,587)	2,741
Accrued interest and taxes .....	419	(18)	(1,001)
Other current liabilities .....	(2,137)	1,885	(3,144)
Dividend income from MGE Transco.....	5,032	6,645	7,740
Cash contributions to pension and other postretirement plans.....	(14,452)	(13,677)	(3,321)
Other noncurrent items, net .....	2,497	4,816	(4,619)
<i>Cash Provided by Operating Activities</i> .....	<u>146,501</u>	<u>148,460</u>	<u>128,538</u>
<b>Investing Activities:</b>			
Capital expenditures .....	(83,659)	(72,030)	(92,676)
Capital contributions to MGE Transco .....	(1,598)	(710)	(1,775)
Other .....	(391)	(180)	(1,146)
<i>Cash Used for Investing Activities</i> .....	<u>(85,648)</u>	<u>(72,920)</u>	<u>(95,597)</u>
<b>Financing Activities:</b>			
Cash dividends paid to parent by MGE.....	(50,000)	(30,000)	(26,500)
Distributions to parent from noncontrolling interest .....	(24,113)	(14,708)	(21,359)
Equity contribution received by noncontrolling interest.....	1,598	3,230	1,775
Repayment of long-term debt .....	(4,267)	(4,182)	(4,103)
(Decrease) increase in short-term debt.....	-	(7,000)	7,000
Other .....	(63)	(682)	-
<i>Cash Used for Financing Activities</i> .....	<u>(76,845)</u>	<u>(53,342)</u>	<u>(43,187)</u>
Change in cash and cash equivalents: .....	(15,992)	22,198	(10,246)
Cash and cash equivalents at beginning of period .....	26,760	4,562	14,808
<b>Cash and cash equivalents at end of period</b> .....	<u><u>\$ 10,768</u></u>	<u><u>\$ 26,760</u></u>	<u><u>\$ 4,562</u></u>
<b>Supplemental disclosures of cash flow information:</b>			
Interest paid.....	\$ 19,415	\$ 19,636	\$ 20,478
Income taxes paid .....	\$ 29	\$ 29	\$ 67
Income taxes received .....	\$ -	\$ -	\$ (644)
Significant noncash investing activities:			
Accrued capital expenditures .....	\$ 16,376	\$ 3,963	\$ 1,569
Dividend in kind to parent .....	\$ 15,822	\$ -	\$ -

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

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

	<b>At December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents.....	\$ 10,768	\$ 26,760
Accounts receivable, less reserves of \$3,017 and \$3,052, respectively .....	39,887	37,112
Affiliate receivables .....	539	542
Other accounts receivable, less reserves of \$426 and \$642, respectively.....	6,363	7,390
Unbilled revenues .....	29,846	25,008
Materials and supplies, at average cost .....	18,561	19,155
Fossil fuel, at average cost .....	9,757	13,110
Stored natural gas, at average cost.....	12,819	16,145
Prepaid taxes .....	25,798	34,279
Regulatory assets - current .....	6,414	9,538
Assets held for sale .....	14,813	-
Other current assets .....	12,268	10,544
<i>Total Current Assets</i> .....	187,833	199,583
Affiliate receivable long-term .....	4,236	4,766
Regulatory assets .....	158,485	148,199
Pension and other postretirement benefit asset .....	2,020	-
Other deferred assets and other.....	4,353	4,216
<b>Property, Plant, and Equipment:</b>		
Property, plant, and equipment, net .....	1,244,648	1,216,415
Construction work in progress .....	36,790	26,351
<i>Total Property, Plant, and Equipment</i> .....	1,281,438	1,242,766
<b>Investments</b> .....	487	69,984
<b>Total Assets</b> .....	\$ 1,638,852	\$ 1,669,514
<b>LIABILITIES AND CAPITALIZATION</b>		
<b>Current Liabilities:</b>		
Long-term debt due within one year .....	\$ 4,333	\$ 4,266
Accounts payable .....	47,790	40,742
Accrued interest and taxes.....	5,440	5,021
Accrued payroll related items .....	11,892	11,215
Regulatory liabilities - current .....	6,910	9,515
Derivative liabilities .....	7,620	8,343
Other current liabilities .....	19,347	4,791
<i>Total Current Liabilities</i> .....	103,332	83,893
<b>Other Credits:</b>		
Deferred income taxes .....	343,117	352,626
Investment tax credit - deferred .....	947	1,050
Regulatory liabilities .....	22,173	20,785
Accrued pension and other postretirement benefits .....	74,347	75,680
Derivative liabilities .....	42,970	44,935
Other deferred liabilities and other .....	66,426	61,817
<i>Total Other Credits</i> .....	549,980	556,893
<b>Capitalization:</b>		
Common shareholder's equity:		
Common Stock - \$1 par value - 50,000 shares authorized; 17,348 shares outstanding .....	17,348	17,348
Additional paid-in capital .....	192,417	192,417
Retained earnings .....	277,300	291,888
Accumulated other comprehensive income, net of tax .....	19	23
<i>Total Common Shareholder's Equity</i> .....	487,084	501,676
Noncontrolling interest .....	115,665	140,308
<i>Total Equity</i> .....	602,749	641,984
Long-term debt .....	382,791	386,744
<i>Total Capitalization</i> .....	985,540	1,028,728
Commitments and contingencies (see Footnote 17) .....	-	-
<b>Total Liabilities and Capitalization</b> .....	\$ 1,638,852	\$ 1,669,514

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

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

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Non- Controlling Interest	Total
	Shares	Value					
<b>2014</b>							
Beginning balance - December 31, 2013 .....	17,348	\$ 17,348	\$ 192,417	\$ 247,534	\$ 192	\$ 118,963	\$ 576,454
Net income .....				55,628		26,310	81,938
Other comprehensive loss .....					(48)		(48)
Cash dividends paid to parent by MGE .....				(26,500)			(26,500)
Equity contribution received by noncontrolling interest .....						1,775	1,775
Distributions to parent from noncontrolling interest .....						(21,359)	(21,359)
Ending balance - December 31, 2014 .....	17,348	\$ 17,348	\$ 192,417	\$ 276,662	\$ 144	\$ 125,689	\$ 612,260
<b>2015</b>							
Beginning balance - January 1, 2015 .....	17,348	\$ 17,348	\$ 192,417	\$ 276,662	\$ 144	\$ 125,689	\$ 612,260
Cumulative effect of new accounting principle ....				(142)			(142)
Beginning balance - Adjusted .....				276,520			612,118
Net income .....				45,368		26,097	71,465
Other comprehensive loss .....					(121)		(121)
Cash dividends paid to parent by MGE .....				(30,000)			(30,000)
Equity contribution received by noncontrolling interest .....						3,230	3,230
Distributions to parent from noncontrolling interest .....						(14,708)	(14,708)
Ending balance - December 31, 2015 .....	17,348	\$ 17,348	\$ 192,417	\$ 291,888	\$ 23	\$ 140,308	\$ 641,984
<b>2016</b>							
Net income .....				51,234		23,358	74,592
Other comprehensive loss .....					(4)		(4)
Cash dividends paid to parent by MGE .....				(50,000)			(50,000)
Dividend in kind to parent .....				(15,822)			(15,822)
Equity contribution received by noncontrolling interest .....						1,598	1,598
Distributions to parent from noncontrolling interest .....						(24,113)	(24,113)
Deconsolidation of noncontrolling interest .....						(25,486)	(25,486)
Ending balance - December 31, 2016 .....	17,348	\$ 17,348	\$ 192,417	\$ 277,300	\$ 19	\$ 115,665	\$ 602,749

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

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## Notes to Consolidated Financial Statements December 31, 2016, 2015, and 2014

This report is a combined report of MGE Energy and MGE. The notes to the consolidated financial statements that follow include consolidated MGE Energy footnotes and certain footnotes related to MGE as signified below.

### 1. Summary of Significant Accounting Policies.

#### a. Basis of Presentation - MGE Energy and MGE.

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), which give recognition to the rate making accounting policies for regulated operations prescribed by the regulatory authorities having jurisdiction, principally the PSCW and FERC. MGE's accounting records conform to the FERC uniform system of accounts.

#### b. Principles of Consolidation - MGE Energy and MGE.

MGE, a wholly owned subsidiary of MGE Energy, is a regulated electric and gas utility headquartered in Madison, Wisconsin. MGE Energy and MGE consolidate all majority owned subsidiaries in which it has controlling influence.

Additional wholly owned subsidiaries of MGE Energy include CWDC, MAGAEL, MGE Power, MGE State Energy Services, MGE Services, MGE Transco, MGEE Transco, and NGV Fueling Services. MGE Power owns 100% of MGE Power Elm Road and MGE Power West Campus. MGE Power and its subsidiaries are part of MGE Energy's nonregulated energy operations, which were formed to own and lease electric generation projects to assist MGE. MGE Transco and MGEE Transco are nonregulated entities formed to manage the investments in ATC and ATC Holdco, respectively. On December 1, 2016, MGE's ownership interest in MGE Transco was transferred to MGE Energy. See Footnote 4 for further discussion of the transfer of MGE's investment in MGE Transco.

MGE Energy and MGE consolidate variable interest entities (VIEs) for which it is the primary beneficiary. Variable interest entities are legal entities that possess any of the following characteristics: equity investors who have an insufficient amount of equity at risk to finance their activities, equity owners who do not have the power to direct the significant activities of the entity (or have voting rights that are disproportionate to their ownership interest), or equity holders who do not receive expected losses or returns significant to the VIE. If MGE Energy or MGE is not the primary beneficiary and an ownership interest is held, the VIE is accounted for under the equity method of accounting. When assessing the determination of the primary beneficiary, all relevant facts and circumstances are considered, including: the power, through voting or similar rights, to direct the activities of the VIE that most significantly impact the VIE's economic performance and the obligation to absorb the expected losses and/or the right to receive the expected returns of the VIE. Ongoing reassessments of all VIEs are performed to determine if the primary beneficiary status has changed. MGE has consolidated MGE Power Elm Road and MGE Power West Campus. Both entities are VIEs. MGE is considered the primary beneficiary of these entities as a result of contractual agreements. See Footnote 2 for more discussion of these entities.

Prior to December 1, 2016, MGE Transco was jointly owned by MGE Energy and MGE. MGE's ownership interest in MGE Transco declined below a majority in July 2016. As a result of the change in majority ownership, MGE deconsolidated MGE Energy's proportionate share of the equity in MGE Transco. See Footnote 8 for further discussion regarding the deconsolidation of noncontrolling interest.

The consolidated financial statements reflect the application of certain accounting policies described in this note. All significant intercompany accounts and transactions have been eliminated in consolidation.

#### c. Use of Estimates - MGE Energy and MGE.

In order to prepare consolidated financial statements in conformity with GAAP, management must make estimates and assumptions. These estimates could affect reported amounts of assets, liabilities, and disclosures at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from management's estimates.

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**d. Cash Equivalents and Restricted Cash - MGE Energy and MGE.**

*Cash Equivalents*

MGE Energy and MGE consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

*Restricted Cash*

MGE has certain cash accounts that are restricted to uses other than current operations and designated for a specific purpose. MGE's restricted cash accounts include cash held by trustees for certain employee benefits and cash deposits held by third parties. As of December 31, 2016 and 2015, there was \$3.7 million and \$2.9 million, respectively, of cash deposits held by third parties. These are included in "Other current assets" on the consolidated balance sheets.

*Receivable – Margin Account*

Cash amounts held by counterparties as margin for certain financial transactions are recorded as receivable – margin account in "Other current assets" on the consolidated balance sheets. As of December 31, 2016 and 2015, the receivable – margin account balance of \$1.3 million and \$2.3 million, respectively, is shown net of any collateral posted against derivative positions. As of December 31, 2016, no cash collateral was posted against derivative positions. As of December 31, 2015, there was \$1.0 million of collateral posted against derivative positions. Changes in this cash account are considered cash flows from operating activities to match with the costs being hedged. The costs being hedged are fuel for electric generation, purchased power, and cost of gas sold.

**e. Trade Receivables, Allowance for Doubtful Accounts, and Concentration Risk - MGE Energy and MGE.**

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. However, a 1% late payment charge is recorded on all receivables unpaid after the due date. The allowance for doubtful accounts associated with these receivables represents our best estimate of the amount of probable credit losses in our existing accounts receivable. We determine our allowance for doubtful accounts based on historical write-off experience, regional economic data, and review of the accounts receivable aging. MGE manages this concentration and the related credit risk through its credit and collection policies, which are consistent with state regulatory requirements.

**f. Inventories - MGE Energy and MGE.**

Inventories consist of natural gas in storage, fossil fuels, materials and supplies, and renewable energy credits (RECs). MGE values natural gas in storage, fossil fuels, and materials and supplies using average cost.

REC allowances are included in "Materials and supplies" on the consolidated balance sheets and are recorded based on specific identification. These allowances are charged to purchase power expense as they are used in operations. MGE's REC allowance balance as of December 31, 2016 and 2015, was \$0.3 million.

**g. Chattel Paper Agreements - 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. The energy-related equipment installed at the customer sites is used to secure the customer loans. MGE is a 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, 2017. 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. The loan balances outstanding at December 31, 2016, approximate the fair value of the energy-related equipment acting as collateral. MGE accounts for these agreements as secured borrowings.

As of December 31, 2016, the remaining contractual maturities of the chattel paper agreements were as follows:

<i>(In thousands)</i>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>Thereafter</u>
Repurchase-to-Maturity Transactions:						
Loans .....	\$ 559	\$ 620	\$ 595	\$ 568	\$ 432	\$ 1,121

**h. Regulatory Assets and Liabilities - MGE Energy and MGE.**

Regulatory assets and regulatory liabilities are recorded consistent with regulatory treatment. Regulatory assets represent costs which are deferred due to the probable future recovery from customers through regulated rates. Regulatory liabilities represent the excess recovery of costs or accrued credits which were deferred because MGE believes it is probable such amounts will be returned to customers through future regulated rates. Regulatory assets and liabilities are amortized in the consolidated statements of income consistent with the recovery or refund included in customer rates. MGE believes that it is probable that its recorded regulatory assets and liabilities will be recovered and refunded, respectively, in future rates. See Footnote 6 for further information.

**i. Debt Issuance Costs - MGE Energy and MGE.**

Premiums, discounts, and expenses incurred with the issuance of outstanding long-term debt are amortized over the life of the debt issue. Any call premiums or unamortized expenses associated with refinancing higher-cost debt obligations used to finance utility-regulated assets and operations are amortized consistent with regulatory treatment of those items. These costs are included as a direct deduction to the related debt liability on the consolidated balance sheets.

**j. Property, Plant, and Equipment - MGE Energy and MGE.**

Property, plant, and equipment is recorded at original cost. Cost includes indirect costs consisting of payroll taxes, pensions, postretirement benefits, other fringe benefits, and administrative and general costs. Also, included in the cost is AFUDC for utility property and capitalized interest for nonregulated property. Additions for significant replacements of property are charged to property, plant, and equipment at cost; and minor items are charged to maintenance expense. Depreciation rates on utility property are approved by the PSCW, based on the estimated economic lives of property, and include estimates for salvage value and removal costs. Removal costs of utility property, less any salvage value, are adjusted through regulatory liabilities. Depreciation rates on nonregulated property are based on the estimated economic lives of the property. See Footnote 3 for further information.

Provisions at composite straight-line depreciation rates approximate the following percentages for the cost of depreciable property:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Electric <sup>(a)</sup>	2.5 %	2.6 %	2.6 %
Gas <sup>(a)</sup>	2.1 %	1.7 %	1.7 %
Nonregulated	2.3 %	2.4 %	2.4 %

(a) In December 2015, the PSCW approved new depreciation rates, which were implemented and became effective as of January 1, 2016.

**k. Asset Retirement Obligations - MGE Energy and MGE.**

MGE Energy and MGE are required to record a liability for the fair value of an ARO to be recognized in the period in which it is incurred if it can be reasonably estimated. The offsetting associated asset retirement costs are capitalized as a long-lived asset and depreciated over the asset's useful life. The expected present value technique used to calculate the fair value of ARO liabilities includes assumptions about costs, probabilities, settlement dates, interest accretion, and inflation. Revisions to the assumptions, including the timing or amount of expected asset retirement costs, could result in increases or decreases to the AROs. All asset retirement obligations are recorded as "Other long-term liabilities" on the consolidated balance sheets. MGE has regulatory treatment and recognizes regulatory assets or liabilities for the timing differences between when we recover legal AROs in rates and when we would recognize these costs. See Footnote 18 for further information.

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**l. Repairs and Maintenance Expense - MGE Energy and MGE.**

MGE utilizes the direct expensing method for planned major maintenance projects. Under this method, MGE expenses all costs associated with major planned maintenance activities as incurred.

**m. Purchased Gas Adjustment Clause - MGE Energy and MGE.**

MGE's natural gas rates are subject to a fuel adjustment clause designed to recover or refund the difference between the actual cost of purchased gas and the amount included in rates. Differences between the amounts billed to customers and the actual costs recoverable are deferred and recovered or refunded in future periods by means of prospective monthly adjustments to rates. At December 31, 2016 and 2015, MGE had over collected \$0.9 million and \$0.8 million, respectively. These amounts are included in "Regulatory liabilities - current" on the consolidated balance sheets.

**n. Revenue Recognition - MGE Energy and MGE.**

Operating revenues are recorded as service is rendered or energy is delivered to customers. Meters are read on a systematic basis throughout the month based on established meter-reading schedules. At the end of the month, MGE accrues an estimate for the unbilled amount of energy delivered to customers. The unbilled revenue estimate is based on daily system demand volumes, weather factors, estimated line losses, estimated customer usage by class, and applicable customer rates.

**o. Utility Cost Recovery - MGE Energy and MGE.**

MGE's rates include a provision for fuel costs. The PSCW allows Wisconsin utilities to defer electric fuel-related costs, less excess revenues, that fall outside a symmetrical cost tolerance band. Any over/under recovery of the actual costs in a year is determined in the following year and is then reflected in future billings to electric retail customers. Such deferred amounts will be recognized in "Purchased power" expense in MGE Energy's and MGE's consolidated income statements each period. The cumulative effects of these deferred amounts will be recorded in "Regulatory assets" or "Regulatory liabilities" on MGE Energy's and MGE's consolidated balance sheets until they are reflected in future billings to customers. See Footnote 16.b. for further information regarding the regulatory rules applicable to the recovery of electric fuel costs.

**p. Regional Transmission Organizations - MGE Energy and MGE.**

MGE reports on a net basis transactions on the MISO markets in which it buys and sells power within the same hour to meet electric energy delivery requirements. This treatment resulted in a \$77.2 million, a \$68.6 million, and a \$91.1 million reduction to sales to the market and purchase power expense for MISO markets for the years ended December 31, 2016, 2015, and 2014, respectively.

**q. Allowance for Funds Used During Construction - MGE Energy and MGE.**

Allowance for funds used during construction is included in utility plant accounts and represents the cost of borrowed funds used during plant construction and a return on shareholder's capital used for construction purposes. In the consolidated income statements, the cost of borrowed funds (AFUDC-debt) is presented as an offset to "Interest expense" and the return on shareholder's capital (AFUDC-equity funds) is shown as an item within "Other income." For both 2016 and 2015, as approved by the PSCW, MGE capitalized AFUDC-debt and equity on 50% of applicable average construction work in progress at 7.93%. For 2014, MGE capitalized AFUDC-debt and equity on 50% of applicable average construction work in progress at 8.21%. For 2016, 2015, and 2014, MGE received specific approval to recover 100% AFUDC on certain environmental costs for Columbia. These amounts are recovered under the ratemaking process over the service lives of the related properties.

**r. Investments - MGE Energy and MGE.**

Investments in limited liability companies that have specific ownership accounts in which MGE Energy or MGE's ownership interest is more than minor and are considered to have significant influence are accounted for using the equity method. All other investments are carried at fair value or at cost, as appropriate. See Footnote 4 for further information.

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**s. Capitalized Software Costs - MGE Energy and MGE.**

Property, plant, and equipment includes the net book value of capitalized costs of internal use software totaling \$12.3 million and \$12.0 million at December 31, 2016 and 2015, respectively. During 2016, 2015, and 2014, MGE recorded \$3.0 million, \$2.2 million, and \$1.6 million, respectively, of amortization expense related to these costs. These costs are amortized on a straight-line basis over the estimated useful lives of the assets. For internal use software, the useful lives range from five to ten years.

**t. Impairment of Long-Lived Assets - MGE Energy and MGE.**

MGE reviews plant and equipment and other property for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. MGE's policy for determining when long-lived assets are impaired is to recognize an impairment loss if the sum of the expected future cash flows (undiscounted and without interest charges) from an asset are less than the carrying amount of that asset. If an impairment loss is recognized, the amount that will be recorded will be measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. There is no impairment of long-lived assets at December 31, 2016, 2015, and 2014.

**u. Income Taxes and Excise Taxes - MGE Energy and MGE.**

*Income taxes*

Under the liability method, income taxes are deferred for all temporary differences between pretax financial and taxable income and between the book and tax basis of assets and liabilities using the tax rates scheduled by law to be in effect when the temporary differences reverse. Future tax benefits are recognized to the extent that realization of such benefits is more likely than not. A valuation allowance is recorded for those benefits that do not meet this criterion.

Accounting for uncertainty in income taxes applies to all tax positions and requires a recognition threshold and measurement standard for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in an income tax return. The threshold is defined for recognizing tax return positions in the financial statements as "more likely than not" that the position is sustainable, based on its merits. Subsequent recognition, derecognition, and measurement is based on management's best judgment given the facts, circumstances, and information available at the reporting date.

Regulatory and accounting principles have resulted in a regulatory liability related to income taxes. Excess deferred income taxes result from past taxes provided at rates higher than current rates. The income tax regulatory liability and deferred investment tax credit reflect the revenue requirement associated with the return of these tax benefits to customers.

Investment tax credits from regulated operations are amortized over related property service lives.

*Excise taxes*

MGE Energy, through its utility operations, pays a state license fee tax in lieu of property taxes on property used in utility operations. License fee tax is calculated as a percentage of adjusted operating revenues of the prior year. The electric tax rate is 3.19% for retail sales and 1.59% for sales of electricity for resale by the purchaser. The tax rate on sales of natural gas is 0.97%. The tax is required to be estimated and prepaid in the year prior to its computation and expensing. License fee tax expense, included in "Other general taxes," was \$14.5 million, \$14.7 million, and \$14.6 million for the years ended December 31, 2016, 2015, and 2014, respectively.

Operating income taxes, including tax credits and license fee tax, are included in rates for utility related items.

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

Under two separate incentive plans, eligible participants, including employees and non-employee directors, 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. Under the plans, these awards are subject to

a prescribed vesting schedule and must be settled in cash. Accordingly, no new shares of common stock are issued in connection with the plans.

MGE Energy and MGE initially measure the cost of the employee or director services received in exchange for a performance unit award based on the current market value of MGE Energy common stock. The fair value of the award is subsequently re-measured at each reporting date through the settlement date. Changes in fair value during the requisite period are recognized as compensation cost over that period.

See Footnote 14 for additional information regarding the plans.

**w. Comprehensive Income - MGE Energy and MGE.**

Total comprehensive income includes all changes in equity during a period except those resulting from investments by and distributions to shareholders. Comprehensive income is reflected in the consolidated statements of comprehensive income.

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

As part of regular operations, MGE enters into contracts, including options, swaps, futures, forwards, and other contractual commitments, to manage its exposure to commodity prices. MGE recognizes all derivatives in the consolidated balance sheets at fair value, with changes in the fair value of derivative instruments to be recorded in current earnings or deferred in accumulated other comprehensive income (loss), depending on whether a derivative is designated as, and is effective as, a hedge and on the type of hedge transaction. Derivative activities are in accordance with the company's risk management policy.

If the derivative qualifies for regulatory deferral, the derivatives are marked to fair value and are offset with a corresponding regulatory asset or liability. Cash flows from such derivative instruments are classified on a basis consistent with the nature of the underlying hedged item.

**2. Variable Interest Entities - MGE Energy and MGE.**

**a. MGE Power Elm Road.**

MGE Power Elm Road is not a subsidiary of MGE; however, it has been consolidated in the financial statements of MGE. MGE Power Elm Road was created for the purpose of owning new generating assets. Its sole principal assets are an undivided ownership interest in two coal-fired generating plants located in Oak Creek, Wisconsin, which it leases to MGE pursuant to long-term leases. Based on the nature and terms of the contractual agreements, MGE is expected to absorb a majority of the expected losses, residual value, or both, associated with the ownership of MGE Power Elm Road and therefore holds a variable interest in MGE Power Elm Road, even though it has no equity interest in MGE Power Elm Road. MGE Energy and MGE consolidate VIEs for which they are the primary beneficiary. MGE has the power to direct the activities that most significantly impact the Elm Road Units' economic performance and is also the party most closely associated with MGE Power Elm Road. As a result, MGE is the primary beneficiary. At December 31, MGE has included the following significant accounts on its consolidated balance sheets related to its interest in this VIE:

<i>(In thousands)</i>	2016	2015
Property, plant, and equipment, net .....	\$ 175,502	\$ 177,904
Construction work in progress .....	3,241	2,400
Deferred income taxes .....	42,525	40,865
Long-term debt .....	62,021	64,622
Noncontrolling interest .....	80,362	79,113

Long-term debt excluding debt issuance costs consists of \$62.6 million at December 31, 2016, of senior secured notes that require that MGE Power Elm Road maintain a projected and actual debt service coverage ratio at the end of any calendar quarter of not less than 1.25 to 1.00 for the trailing 12-month period. The debt is secured by a collateral assignment of lease payments that MGE is making to MGE Power Elm Road for use of the Elm Road Units pursuant to the related long-term leases. As of December 31, 2016, MGE Power Elm Road is in compliance with the covenant requirements.

MGE has been and will continue to recover in rates the lease payments made to MGE Power Elm Road. MGE received approval from the PSCW to collect in rates the carrying costs incurred by MGE Power Elm Road. The total carrying costs on the Elm Road Units is \$62.5 million. MGE collected carrying costs in rates over a six year period that began in 2010. Of these costs, \$17.0 million relates to the capitalized interest and the debt portion of the units. These costs will be recognized over the period in which the generating units will be depreciated. The remaining \$45.5 million represents the equity portion and was recognized over the period allowed for recovery in rates which ended in 2015.

**b. MGE Power West Campus.**

MGE Power West Campus is not a subsidiary of MGE; however, it has been consolidated in the financial statements of MGE. MGE Power West Campus was created for the purpose of owning new generating assets. Its sole principal asset is the WCCF, which it leases to MGE pursuant to a long-term lease. MGE is responsible for operation of the plant during the term of the lease. Based on the nature and terms of these contractual relationships, MGE absorbs a majority of the expected losses, residual value, or both, associated with the ownership and operation of the WCCF and therefore holds a variable interest in MGE Power West Campus, even though it has no equity interest in MGE Power West Campus. MGE has the power to direct the activities that most significantly impact WCCF's economic performance and is also the party most closely associated with MGE Power West Campus. As a result, MGE is the primary beneficiary. At December 31, MGE has included the following significant accounts on its consolidated balance sheets related to its interest in this VIE:

<i>(In thousands)</i>	2016	2015
Property, plant, and equipment, net .....	\$ 81,588	\$ 84,403
Affiliate receivables .....	4,769	5,295
Deferred income taxes .....	19,912	19,612
Long-term debt .....	44,932	46,510
Noncontrolling interest .....	35,303	37,603

Long-term debt excluding debt issuance costs consists of \$45.1 million at December 31, 2016, of senior secured notes that require that MGE Power West Campus maintain a projected debt service coverage ratio of not less than 1.25 to 1.00 and debt to total capitalization ratio of not more than 0.65 to 1.00. The debt is secured by a collateral assignment of lease payments that MGE is making to MGE Power West Campus for use of the cogeneration facility pursuant to the long-term lease. As of December 31, 2016, MGE Power West Campus is in compliance with the covenant requirements.

MGE has been and will continue to recover lease payments made to MGE Power West Campus in rates. Also, MGE received approval from the PSCW to collect approximately \$12.1 million in carrying costs incurred by MGE Power West Campus during construction of the facility. The carrying costs were recovered in rates over a 10 year period that started in 2005 and ended in 2015.

**c. Other Variable Interest Entities.**

MGE has a variable interest in entities through purchase power agreements relating to purchased energy from the facilities covered by the agreements. As of December 31, 2016 and 2015, MGE had 51 megawatts and 61 megawatts, respectively, of capacity available under these agreements. MGE evaluated the variable interest entities for possible consolidation. The interest holder is considered the primary beneficiary of the entity and is required to consolidate the entity if the interest holder has the power to direct the activities that most significantly impact the economics of the variable interest entity. MGE examined qualitative factors such as the length of the remaining term of the contracts compared with the remaining lives of the plants, who has the power to direct the operations and maintenance of the facilities, and other factors, and determined MGE is not the primary beneficiary of the variable interest entities. There is not a significant potential exposure to loss as a result of involvement with these variable interest entities.

### 3. Property, Plant, and Equipment - MGE Energy and MGE.

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

(In thousands)	MGE Energy		MGE	
	2016	2015	2016	2015
<b>Utility:</b>				
Electric <sup>(a)</sup> .....	\$ 1,171,004	\$ 1,147,701	\$ 1,171,021	\$ 1,147,718
Gas .....	395,790	384,163	395,801	384,175
Total utility plant .....	1,566,794	1,531,864	1,566,822	1,531,893
Less: Accumulated depreciation and amortization <sup>(a)</sup> .....	579,965	578,410	579,965	578,410
In-service utility plant, net.....	986,829	953,454	986,857	953,483
<b>Nonregulated:</b>				
Nonregulated .....	317,810	315,589	317,014	314,750
Less: Accumulated depreciation and amortization .....	59,370	51,949	59,223	51,818
In-service nonregulated plant, net .....	258,440	263,640	257,791	262,932
<b>Construction work in progress:</b>				
Utility construction work in progress <sup>(a)</sup> .....	31,356	23,837	31,356	23,837
Nonregulated construction work in progress.....	5,434	2,514	5,434	2,514
Total property, plant, and equipment .....	\$ 1,282,059	\$ 1,243,445	\$ 1,281,438	\$ 1,242,766

(a) As of December 31, 2016, MGE has classified \$14.8 million of Columbia assets as held-for-sale on the consolidated balance sheets related to the partial sale of plant assets to WPL. See Footnote 5.a. for further discussion.

MGE's utility plant is subject to the lien of its Indenture of Mortgage and Deed of Trust. As of December 31, 2016 and 2015, there was \$1.2 million of bonds outstanding under that indenture. See Footnote 9 for further discussion of the mortgage indenture.

### 4. Investments - MGE Energy and MGE.

#### a. Equity Method Investments, Available for Sale Securities, and Other Investments.

(In thousands)	MGE Energy		MGE	
	2016	2015	2016	2015
Available for sale securities:				
Cost basis .....	\$ 2,216	\$ 2,225	\$ 455	\$ 480
Gross unrealized gains .....	346	599	40	40
Gross unrealized losses .....	(8)	(2)	(8)	(2)
Fair value .....	2,554	2,822	487	518
Equity method investments:				
ATC and ATC Holdco <sup>(a)</sup> .....	72,458	69,466	-	69,466
Other.....	1,158	1,184	-	-
Total equity method investments.....	73,616	70,650	-	69,466
Other investments .....	120	159	-	-
Total .....	\$ 76,290	\$ 73,631	\$ 487	\$ 69,984

(a) MGE Transco holds an ownership interest in ATC, and MGEE Transco holds an ownership interest in ATC Holdco. In July 2016, MGE's ownership interest in MGE Transco declined below a majority, resulting in MGE Energy's investment in MGE Transco being deconsolidated from MGE's consolidated financial statements. See Footnote 8 for further discussion of noncontrolling interest. In December 2016, MGE's ownership interest in MGE Transco was transferred to MGE Energy, see "ATC and ATC Holdco" below for additional information.

MGE Energy's and MGE's available for sale securities represent publicly traded securities and private equity investments in common stock of companies in various industries.

During the years ended December 31, 2016, 2015, and 2014, certain investments were liquidated. As a result of these liquidations, MGE Energy and MGE received the following:

<i>(In thousands)</i>	MGE Energy			MGE		
	2016	2015	2014	2016	2015	2014
Cash proceeds .....	\$ 408	\$ 19	\$ 38	\$ 16	\$ 19	\$ -
Gain (loss) on sale .....	121	10	21	(8)	10	-

**b. ATC and ATC Holdco.**

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 as required by Wisconsin law. That interest is presently held by MGE Transco, which, as of December 1, 2016, is owned by MGE Energy. ATC Holdco was formed by several members of ATC, including MGE Energy, to pursue electric transmission development and investments outside of Wisconsin. The ownership interest in ATC Holdco is held by MGEE Transco, a wholly-owned subsidiary of MGE Energy.

MGE Transco and MGEE Transco have accounted for their investment in ATC and ATC Holdco, respectively, under the equity method of accounting. For the years ended December 31, 2016, 2015, and 2014, MGE Transco recorded the following:

<i>(In thousands)</i>	2016	2015	2014
Equity earnings from investment in ATC .....	\$ 8,670	\$ 7,728	\$ 9,150
Dividends received from ATC <sup>(a)</sup> .....	7,926	6,645	7,740
Capital contributions to ATC .....	2,486	710	1,775

(a) As of December 31, 2016, MGE Transco recorded a \$2.1 million receivable from ATC for a cash dividend received in January 2017.

ATC Holdco's activities commenced in late December 2016 and had an immaterial impact on results of operations, cash flows, and financial condition.

At December 31, 2016 and 2015, MGE Transco held a 3.6% ownership interest in ATC. At December 31, 2016, MGEE Transco held a 4.0% ownership interest in ATC Holdco. On January 31, 2017, MGE Transco made a \$1.4 million capital contribution to ATC, and on January 10, 2017, MGEE Transco made a \$0.2 million capital contribution to ATC Holdco.

In June 2016, the PSCW required MGE to transfer its interest in ATC to MGE Energy, which was to be completed by December 31, 2022. The requirement arose in the context of requests for regulatory approvals by several owners of ATC in connection with a reorganization of ATC. MGE's ownership interest in ATC, held through MGE Transco, was transferred net of deferred tax liabilities to MGE Energy by way of a dividend in kind of \$15.8 million as of December 1, 2016. As a result of the transfer, MGE's ownership interest in MGE Transco was completely eliminated in favor of MGE Energy. See Footnote 12 for further discussion of the transfer of deferred tax liabilities. The change had no effect on MGE Energy's consolidated financial statements.

ATC's summarized financial data for the years ended December 31, 2016, 2015, and 2014 is as follows:

(In thousands)

<b>Income statement data for the year ended December 31,</b>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating revenues .....	\$ 650,806	\$ 615,836	\$ 635,033
Operating expenses .....	(322,517)	(319,321)	(307,451)
Other income .....	3,225	1,176	117
Interest expense, net .....	(98,758)	(97,250)	(88,970)
Earnings before members' income taxes .....	<u>\$ 232,756</u>	<u>\$ 200,441</u>	<u>\$ 238,729</u>

<b>Balance sheet data as of December 31,</b>	<u>2016</u>	<u>2015</u>
Current assets .....	\$ 75,790	\$ 80,520
Noncurrent assets .....	4,312,893	3,948,265
Total assets .....	<u>\$ 4,388,683</u>	<u>\$ 4,028,785</u>
Current liabilities .....	\$ 495,126	\$ 330,248
Long-term debt .....	1,865,302	1,790,718
Other noncurrent liabilities .....	271,495	244,991
Members' equity .....	<u>1,756,760</u>	<u>1,662,828</u>
Total members' equity and liabilities .....	<u>\$ 4,388,683</u>	<u>\$ 4,028,785</u>

## 5. Joint Plant Ownership - MGE Energy and MGE.

### a. Columbia.

MGE and two other utilities jointly own Columbia, a coal-fired generating facility located in Portage, Wisconsin, which, at December 31, 2016, accounts for 30% (225 MW) of MGE's net summer rated capacity. Power from this facility is shared in proportion to each company's ownership interest. At December 31, 2016, MGE had a 22.0% ownership interest in Columbia. The other owners are WPL, which operates Columbia, and WPSC. MGE's share of fuel, operating, and maintenance expenses for Columbia was \$39.5 million, \$38.2 million, and \$28.1 million for the years ended December 31, 2016, 2015, and 2014, respectively.

Each owner provides its own financing and reflects its respective portion of facilities and operating costs in its financial statements. MGE's interest in Columbia's gross utility plant in service, and the related accumulated depreciation reserves at December 31 were as follows:

(In thousands)	<u>2016</u>	<u>2015</u>
Utility plant .....	\$ 270,898	\$ 273,762
Accumulated depreciation .....	(81,935)	(84,864)
Property, plant, and equipment, net .....	188,963	188,898
Construction work in progress .....	21,120	17,110
Total property, plant, and equipment .....	<u>\$ 210,083</u>	<u>\$ 206,008</u>

In 2016, MGE and WPL negotiated an amendment to the existing Columbia joint operating agreement, that has been approved by the PSCW, under which MGE will have the option to reduce its obligation to pay certain capital expenditures (other than SCR-related expenditures) at Columbia in exchange for a proportional reduction in MGE's ownership in Columbia. On January 1 of each year, beginning in 2017 and ending June 1, 2020, the ownership percentage will be adjusted, through a partial sale, based on the amount of capital expenditures foregone. In December 2016, MGE jointly filed a request with the co-owners of Columbia for FERC approval of the amendment to the Columbia joint operating agreement, effective January 1, 2017. MGE currently expects to receive FERC's decision on the amendment in 2017.

During 2016, MGE accrued \$14.8 million of 2016 capital expenditures that MGE has forgone as part of the ownership transfer agreement with WPL. As of December 31, 2016, MGE classified \$14.8 million of Columbia assets as held-for-sale on the consolidated balance sheets. In January 2017, MGE reduced its ownership interest in Columbia from 22.0% to 20.4% through the partial sale of plant assets to WPL.

**b. Elm Road.**

MGE Power Elm Road owns an 8.33% ownership interest in each of two 615 MW coal-fired generating units in Oak Creek, Wisconsin, which, at December 31, 2016, accounts for 14% (106 MW) of MGE's net summer rated capacity. Unit 1 entered commercial operation on February 2, 2010. Unit 2 entered commercial operation on January 12, 2011. MGE Power Elm Road's sole principal asset is that ownership interest in those generating units. MGE Power Elm Road's interest in the Elm Road Units is leased to MGE pursuant to long-term leases.

The remainder of the ownership interest in the Elm Road Units is held by two other entities, one of which is also responsible for the Units' operation. Each owner provides its own financing and reflects its respective portion of the facility and costs in its financial statements. MGE's share of fuel, operating, and maintenance expenses for the Elm Road Units was \$21.2 million, \$20.9 million, and \$20.3 million for the years ended December 31, 2016, 2015, and 2014, respectively. MGE Power Elm Road's interest in the portion of the Elm Road Units in-service and the related accumulated depreciation reserves at December 31 were as follows:

<i>(In thousands)</i>	2016	2015
Nonregulated plant .....	\$ 204,292	\$ 202,326
Accumulated depreciation .....	(28,790)	(24,422)
Property, plant, and equipment, net .....	175,502	177,904
Construction work in progress .....	3,241	2,400
Total property, plant, and equipment .....	<u>\$ 178,743</u>	<u>\$ 180,304</u>

**c. WCCF.**

MGE Power West Campus and the UW jointly own the West Campus Cogeneration Facility located on the UW campus in Madison, Wisconsin. MGE Power West Campus owns 55% of the facility and the UW owns 45% of the facility. The UW owns a controlling interest in the chilled-water and steam plants, which are used to meet the growing needs for air-conditioning and steam-heat capacity for the UW campus. MGE Power West Campus owns a controlling interest in the electric generation plant, which is leased and operated by MGE.

Each owner provides its own financing and reflects its respective portion of the facility and operating costs in its financial statements. MGE Power West Campus' interest in WCCF and the related accumulated depreciation reserves at December 31 were as follows:

<i>(In thousands)</i>	2016	2015
Nonregulated plant .....	\$ 111,330	\$ 111,141
Accumulated depreciation .....	(29,742)	(26,738)
Property, plant, and equipment, net .....	81,588	84,403
Construction work in progress .....	1,009	113
Total property, plant, and equipment .....	<u>\$ 82,597</u>	<u>\$ 84,516</u>

Operating charges are allocated to the UW based on formulas contained in the operating agreement. Under the provisions of this arrangement, the UW is required to reimburse MGE for their allocated portion of fuel and operating expenses. For the years ended December 31, 2016, 2015, and 2014, the UW allocated share of fuel and operating costs was \$5.5 million, \$3.7 million, and \$2.8 million, respectively.

## 6. Regulatory Assets and Liabilities - MGE Energy and MGE.

The following regulatory assets and liabilities are reflected in MGE's consolidated balance sheets as of December 31:

<i>(In thousands)</i>	<u>2016</u>	<u>2015</u>
<b>Regulatory Assets</b>		
Asset retirement obligation.....	\$ 5,563	\$ 4,849
Conservation costs .....	444	-
Debt related costs.....	10,211	10,672
Derivatives .....	49,281	54,083
Environmental costs .....	55	368
Tax recovery related to AFUDC equity .....	9,403	8,950
Unfunded pension and other postretirement liability .....	86,475	78,181
Other .....	3,467	634
<i>Total Regulatory Assets</i> .....	<u>\$ 164,899</u>	<u>\$ 157,737</u>
<b>Regulatory Liabilities</b>		
Conservation costs .....	\$ -	\$ 231
Deferred fuel savings.....	6,016	9,515
Elm Road .....	3,473	643
Income taxes .....	1,302	1,559
Non-ARO removal costs.....	16,415	17,137
Renewable energy credits.....	339	327
Other .....	1,538	888
<i>Total Regulatory Liabilities</i> .....	<u>\$ 29,083</u>	<u>\$ 30,300</u>

MGE expects to recover its regulatory assets and return its regulatory liabilities through rates charged to customers based on PSCW decisions made during the ratemaking process or based on PSCW long-standing policies and guidelines. The adjustments to rates for these regulatory assets and liabilities will occur over the periods either specified by the PSCW or over the corresponding period related to the asset or liability. Management believes it is probable that MGE will continue to recover from customers the regulatory assets described above based on prior and current ratemaking treatment for such costs. All regulatory assets for which a cash outflow had been made are earning a return, except for amounts expended for environmental costs.

### ***Asset Retirement Obligation***

See Footnote 18 for further discussion.

### ***Conservation Costs***

MGE has received regulatory treatment for certain conservation expenditures. The expenditures are used for Focus on Energy programs, Wisconsin's statewide energy efficiency and renewable resource program, to promote energy efficiency on the customer's premises. Costs for Focus on Energy programs are estimated in MGE's rates utilizing escrow accounting. The escrow accounting allows the utility to true-up its actual costs incurred and reflect the amount of the true-up in its next rate case filing.

### ***Debt Related Costs***

This balance includes debt issuance costs of extinguished debt and other debt related expenses, including make-whole premiums. The PSCW has allowed rate recovery on unamortized issuance costs for extinguished debt facilities. When the facility replacing the old facility is deemed by the PSCW to be more favorable for the ratepayers, the PSCW will allow rate recovery of any unamortized issuance costs related to the old facility. These amounts are recovered over the term of the new facility.

### ***Derivatives***

MGE has physical and financial contracts that are defined as derivatives. The amounts recorded for the net mark-to-market value of the commodity based contracts is offset with a corresponding regulatory asset or liability because these transactions are part of the PGA or fuel rules clause authorized by the PSCW. A significant portion of the recorded amount is related to a purchased power agreement that provides MGE with firm capacity and energy during a base term from June 1, 2012, through May 31, 2022. This agreement is accounted for as a derivative contract. See Footnote 15 for further discussion.

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### ***Environmental Costs***

MGE has been allowed to defer actual costs on certain environmental matters, including clean up of two landfill sites and legal expenditures pertaining to the response to the EPA Clean Air Act enforcement matter at Columbia. For further discussion of the Columbia Clean Air Act litigation, see Footnote 17.c.

### ***Tax Recovery Related to AFUDC Equity***

AFUDC equity represents the after-tax equity cost associated with utility plant construction and results in a temporary difference between the book and tax basis of such plant. It is probable under PSCW regulation that MGE will recover in future rates the future increase in taxes payable represented by the deferred income tax liability. The amounts will be recovered in rates over the depreciable life of the asset for which AFUDC was applied. Tax recovery related to AFUDC equity represents the revenue requirement related to recovery of these future taxes payable, calculated at current statutory tax rates.

### ***Unfunded Pension and Other Postretirement Liability***

MGE is required to recognize the unfunded status of defined benefit pension and other postretirement pension plans as a net liability or asset on the balance sheet with an offset to a regulatory asset or liability. The unfunded status represents future expenses that are expected to be recovered in rates. See Footnote 13 for further discussion.

### ***Deferred Fuel Savings***

The fuel rules require the PSCW and Wisconsin utilities to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band. Any over/under recovery of the actual costs is determined on an annual basis and is adjusted in future billings to electric retail customers. See Footnote 16.b. for further discussion.

### ***Elm Road***

Costs associated with Elm Road are estimated in MGE's rates utilizing escrow accounting and include costs for lease payments, management fees, community impact mitigation, and operating costs. Also, MGE has deferred payments made to MGE Power Elm Road for carrying costs during construction of the facility. MGE has collected the carrying costs in rates over a six year period that ended in 2015. All other costs are collected in rates over a one to two year period.

### ***Income Taxes***

Excess deferred income taxes result from past taxes provided at rates higher than current rates. The regulatory liability and deferred investment tax credit reflects the revenue requirement associated with the return of these tax benefits to customers.

### ***Non-ARO Removal Costs***

In connection with accounting for asset retirement obligations, companies are required to reclassify cumulative collections for non-ARO removal costs as a regulatory liability, with an offsetting entry to accumulated depreciation. Under the current rate structure, these removal costs are being recovered as a component of depreciation expense.

### ***Renewable Energy Credits***

MGE receives renewable energy credits from certain purchase power agreements. The value of the credits are recorded as inventory and expensed when the credit is redeemed or expired. A regulatory liability has been established for the value of the renewable energy credits included in inventory. In Wisconsin, renewable energy credits expire four years after the year of acquisition.

## **7. Common Equity.**

### **a. Common Stock - MGE Energy and MGE.**

On December 20, 2013, MGE Energy's Board of Directors declared a three-for-two stock split of MGE Energy's outstanding shares of common stock, effective in the form of a stock dividend. Shareholders of record at the close of business on January 24, 2014, received one additional share of MGE Energy common stock for every two shares of common stock owned on that date. The additional shares were distributed on February 7, 2014. Shareholders received cash in lieu of any fractional shares of common stock they otherwise would have received in connection with the dividend. All share and per share data provided in this report give effect to this stock split.

MGE Energy sells shares of its common stock through its Stock Plan. Those shares may be newly issued shares or shares that MGE Energy has purchased in the open market for resale to participants in the Stock Plan. All sales under the Stock Plan are covered by a shelf registration statement that MGE Energy filed with the SEC. For the years ended December 31, 2016 and 2015, MGE Energy did not issue any new shares of common stock under the Stock Plan.

MGE Energy purchases shares on the open market 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 specific maximum number of shares to be repurchased and no specified termination date for the repurchases.

During the years ended December 31, 2016 and 2015, MGE Energy paid \$41.8 million (or \$1.21 per share) and \$40.0 million (or \$1.16 per share), respectively, in cash dividends on its common stock. Dividend payments by MGE to MGE Energy are subject to restrictions arising under a PSCW rate order and, to a lesser degree, MGE's first mortgage bonds. The PSCW order restricts any dividends, above the PSCW authorized amount that MGE may pay MGE Energy if its common equity ratio, calculated in the manner used in the rate proceeding, is less than 55%. See Footnote 9 for further discussion of the mortgage indenture covenants. During the years ended December 31, 2016 and 2015, MGE paid \$50.0 million and \$30.0 million, respectively, in cash dividends to MGE Energy. In 2016, MGE also transferred its ownership interest in MGE Transco to MGE Energy in the form of a dividend in kind of \$15.8 million. See Footnote 4 for further information.

**b. Dilutive Shares Calculation - MGE Energy.**

MGE Energy does not hold any dilutive securities.

**8. Noncontrolling Interest - MGE.**

The noncontrolling interest on MGE's consolidated balance sheets at December 31 was as follows:

<i>(In thousands)</i>	2016	2015
MGE Power Elm Road <sup>(a)</sup> .....	\$ 80,362	\$ 79,113
MGE Power West Campus <sup>(a)</sup> .....	35,303	37,603
MGE Transco <sup>(b)</sup> .....	-	23,592
Total Noncontrolling Interest.....	<u>\$ 115,665</u>	<u>\$ 140,308</u>

The net income attributable to noncontrolling interest, net of tax, for the years ended December 31, 2016, 2015, and 2014 was as follows:

<i>(In thousands)</i>	2016	2015	2014
MGE Power Elm Road <sup>(a)</sup> .....	\$ 14,748	\$ 16,577	\$ 16,160
MGE Power West Campus <sup>(a)</sup> .....	7,200	7,348	7,666
MGE Transco <sup>(b)</sup> .....	1,410	2,172	2,484
Net Income Attributable to Noncontrolling Interest, Net of Tax.....	<u>\$ 23,358</u>	<u>\$ 26,097</u>	<u>\$ 26,310</u>

(a) MGE Power Elm Road and MGE Power West Campus are not subsidiaries of MGE; however, they have been consolidated in the consolidated financial statements of MGE (see Footnote 2). MGE Power Elm Road and MGE Power West Campus are 100% owned by MGE Power, and MGE Power is 100% owned by MGE Energy. MGE Energy's proportionate share of the equity and net income (through its wholly owned subsidiary MGE Power) of MGE Power Elm Road and MGE Power West Campus is classified within the MGE consolidated financial statements as noncontrolling interest.

(b) At December 31, 2016, MGE Energy is the owner of MGE Transco. In July 2016, MGE's ownership interest in MGE Transco declined below a majority as a result of continued funding of ATC capital contributions by MGE Energy. As a result of the change in majority ownership in MGE Transco, MGE deconsolidated MGE Energy's proportionate share of the equity in MGE Transco. The change in consolidation was applied prospectively by reducing its investment and noncontrolling interest on MGE's consolidated financial statements. The change had no effect on MGE Energy's consolidated financial

statements; however, MGE Energy's proportionate share of the equity and net income of MGE Transco classified as noncontrolling interest was deconsolidated from MGE's financial statements. No gain or loss was recognized in July 2016 due to MGE ceasing to have a controlling financial interest.

## 9. Long-Term Debt - MGE Energy and MGE.

### a. Long-Term Debt.

<i>(In thousands)</i>	2016		2015	
	MGE Energy	MGE	MGE Energy	MGE
<b>First Mortgage Bonds:</b> <sup>(a)</sup>				
7.70%, 2028 Series.....	\$ 1,200	\$ 1,200	\$ 1,200	\$ 1,200
<b>Tax Exempt Debt:</b>				
3.45%, 2027 Series, Industrial Development Revenue Bonds .....	19,300	19,300	19,300	19,300
<b>Medium-Term Notes:</b> <sup>(b)</sup>				
5.25%, due 2017 <sup>(c)</sup> .....	30,000	30,000	30,000	30,000
6.12%, due 2028 .....	20,000	20,000	20,000	20,000
7.12%, due 2032 .....	25,000	25,000	25,000	25,000
6.247%, due 2037 .....	25,000	25,000	25,000	25,000
<i>Total Medium-Term Notes</i> .....	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>
<b>Other Long-Term Debt:</b> <sup>(d)</sup>				
5.59%, due 2018 <sup>(e)</sup> .....	20,000	20,000	20,000	20,000
3.38%, due 2020 <sup>(e)</sup> .....	15,000	15,000	15,000	15,000
3.09%, due 2023 <sup>(e)</sup> .....	30,000	30,000	30,000	30,000
3.29%, due 2026 <sup>(e)</sup> .....	15,000	15,000	15,000	15,000
5.68%, due 2033 <sup>(f)</sup> .....	27,120	27,120	28,063	28,063
5.19%, due 2033 <sup>(f)</sup> .....	17,983	17,983	18,640	18,640
5.26%, due 2040 <sup>(e)</sup> .....	15,000	15,000	15,000	15,000
5.04%, due 2040 <sup>(g)</sup> .....	38,472	38,472	40,138	40,138
4.74%, due 2041 <sup>(g)</sup> .....	24,167	24,167	25,167	25,167
4.38%, due 2042 <sup>(e)</sup> .....	28,000	28,000	28,000	28,000
4.42%, due 2043 <sup>(e)</sup> .....	20,000	20,000	20,000	20,000
4.47%, due 2048 <sup>(e)</sup> .....	20,000	20,000	20,000	20,000
<i>Total Other Long-Term Debt</i> .....	<u>270,742</u>	<u>270,742</u>	<u>275,008</u>	<u>275,008</u>
Long-term debt due within one year .....	(4,333)	(4,333)	(4,266)	(4,266)
Unamortized discount and debt issuance costs.....	(4,118)	(4,118)	(4,498)	(4,498)
<i>Total Long-Term Debt</i> .....	<u>\$ 382,791</u>	<u>\$ 382,791</u>	<u>\$ 386,744</u>	<u>\$ 386,744</u>

(a) MGE's utility plant is subject to the lien of its Indenture of Mortgage and Deed of Trust, under which its first mortgage bonds are issued. The Mortgage Indenture provides that dividends or any other distribution or purchase of shares may not be made if the aggregate amount thereof since December 31, 1945 would exceed the earned surplus (retained earnings) accumulated subsequent to December 31, 1945. As of December 31, 2016, approximately \$338.5 million was available for the payment of dividends under this covenant.

(b) The indenture under which MGE's Medium-Term notes are issued provides that those notes will be entitled to be equally and ratably secured in the event that MGE issues any additional first mortgage bonds.

(c) MGE had \$30 million of medium-term notes mature in January 2017. MGE issued \$40 million of new long-term unsecured debt on January 13, 2017, to refinance the maturing \$30 million medium-term notes and assist with the financing of additional capital expenditures. The new debt carries an interest rate of 3.76% per annum over its 35-year term. The covenants of this debt are substantially consistent with MGE's existing unsecured long-term debt. In accordance with applicable accounting guidance, MGE has classified the \$30 million of maturing medium-term notes as long-term debt on the consolidated balance sheets for the year ended December 31, 2016.

- (d) Unsecured notes issued pursuant to various Note Purchase Agreements with one or more purchasers. The notes are not issued under, or governed by, MGE's Indenture dated as of September 1, 1998, which governs MGE's Medium-Term Notes.
- (e) Issued by MGE. Under that Note Purchase Agreement: (i) note holders have the right to require MGE to repurchase their notes at par in the event of an acquisition of beneficial ownership of 30% or more of the outstanding voting stock of MGE Energy, (ii) MGE must maintain a ratio of its consolidated indebtedness to consolidated total capitalization not to exceed a maximum of 65%, and (iii) MGE cannot issue "Priority Debt" in an amount exceeding 20% of its consolidated assets. Priority Debt is defined as any indebtedness of MGE secured by liens other than specified liens permitted by the Note Purchase Agreement and certain unsecured indebtedness of certain subsidiaries. As of December 31, 2016, MGE was in compliance with the covenant requirements.
- (f) Issued by MGE Power West Campus. The Note Purchase Agreements require it to maintain a projected debt service coverage ratio of not less than 1.25 to 1.00, and debt to total capitalization ratio of not more than 0.65 to 1.00. The notes are secured by a collateral assignment of lease payments that MGE is making to MGE Power West Campus for use of its ownership interest in the WCCF pursuant to a long-term lease. As of December 31, 2016, MGE Power West Campus was in compliance with the covenant requirements.
- (g) Issued by MGE Power Elm Road. The Note Purchase Agreement requires MGE Power Elm Road to maintain a projected and actual debt service coverage ratio at the end of any calendar quarter of not less than 1.25 to 1.00 for the trailing 12-month period. The notes are secured by a collateral assignment of lease payments that MGE is making to MGE Power Elm Road for use of its ownership interest in the Elm Road Units pursuant to long-term leases. As of December 31, 2016, MGE Power Elm Road was in compliance with the covenant requirements.

**b. Long-Term Debt Maturities.**

Below is MGE Energy's and MGE's aggregate maturities for all long-term debt for years following December 31, 2016.

<i>(In thousands)</i>	MGE	
	Energy	MGE *
2017 .....	\$ 4,358	4,358
2018 .....	24,452	24,452
2019 .....	4,553	4,553
2020 .....	19,659	19,659
2021 .....	4,771	4,771
Future years .....	333,449	333,449
Total.....	\$ <u>391,242</u>	\$ <u>391,242</u>

*\*Includes \$45.1 million for MGE Power West Campus and \$62.6 million for MGE Power Elm Road, all of which are consolidated with MGE's debt (see Footnote 2 for further information).*

**10. Notes Payable to Banks, Commercial Paper, and Lines of Credit.**

**a. MGE Energy.**

At December 31, 2016, MGE Energy had an unsecured, committed revolving line of credit of \$50 million expiring June 1, 2020. At December 31, 2016, no borrowings were outstanding under this facility.

The agreement requires MGE Energy to maintain a ratio of its consolidated indebtedness to consolidated total capitalization not to exceed a maximum of 65%. A change in control constitutes a default under the agreement. Change in control events are defined as (i) a failure by MGE Energy to hold 100% of the outstanding voting equity interest in MGE or (ii) the acquisition of beneficial ownership of 30% or more of the outstanding voting stock of MGE Energy by one person or two or more persons acting in concert. As of December 31, 2016, MGE Energy was in compliance with the covenant requirements.

**b. MGE.**

For short-term borrowings, MGE generally issues commercial paper (issued at the prevailing discount rate at the time of issuance), which is supported by unused committed bank lines of credit. At December 31, 2016, MGE had two unsecured, committed revolving lines of credit for a total of \$100 million expiring June 1, 2020. At December 31, 2016, no borrowings were outstanding under these facilities, and MGE had no commercial paper outstanding.

The agreements require MGE to maintain a ratio of consolidated debt to consolidated total capitalization not to exceed a maximum of 65%. The ratio calculation excludes assets, liabilities, revenues, and expenses included in MGE's financial statements as the result of the consolidation of VIEs, such as MGE Power West Campus and MGE Power Elm Road. A change in control constitutes a default under the agreements. Change in control events are defined as (i) a failure by MGE Energy to hold 100% of the outstanding voting equity interest in MGE or (ii) the acquisition of beneficial ownership of 30% or more of the outstanding voting stock of MGE Energy by one person or two or more persons acting in concert. As of December 31, 2016, MGE was in compliance with the covenant requirements.

**c. MGE Energy and MGE.**

Information concerning short-term borrowings for the past two years is shown below:

<i>(In thousands)</i>	As of December 31,	
	2016	2015
<b>MGE Energy<sup>(a)</sup></b>		
Available lines of credit .....	\$ 150,000	\$ 150,000
Short-term debt outstanding.....	\$ -	\$ -
Weighted-average interest rate .....	-%	-%
<i>During the year:</i>		
Maximum short-term borrowings .....	\$ -	\$ 17,500
Average short-term borrowings.....	\$ -	\$ 1,511
Weighted-average interest rate .....	-%	0.17%
<b>MGE</b>		
Available lines of credit .....	\$ 100,000	\$ 100,000
Commercial paper outstanding.....	\$ -	\$ -
Weighted-average interest rate .....	-%	-%
<i>During the year:</i>		
Maximum short-term borrowings .....	\$ -	\$ 17,500
Average short-term borrowings.....	\$ -	\$ 1,511
Weighted-average interest rate .....	-%	0.17%

(a) MGE Energy short-term borrowings include MGE Energy and MGE lines of credit and MGE commercial paper.

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

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

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

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

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

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

At December 31, 2016 and 2015, the carrying amount of cash, cash equivalents, and outstanding commercial paper 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 December 31. Since long-term debt is not traded in an active market, it is classified as Level 2. The estimated fair market value of financial instruments are as follows:

<i>(In thousands)</i>	2016		2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>MGE Energy</b>				
<i>Assets:</i>				
Cash and cash equivalents .....	\$ 95,959	\$ 95,959	\$ 81,384	\$ 81,384
<i>Liabilities:</i>				
Long-term debt <sup>(a)</sup> .....	391,242	430,122	395,508	435,767
<b>MGE</b>				
<i>Assets:</i>				
Cash and cash equivalents .....	\$ 10,768	\$ 10,768	\$ 26,760	\$ 26,760
<i>Liabilities:</i>				
Long-term debt <sup>(a)</sup> .....	391,242	430,122	395,508	435,767

(a) Includes long-term debt due within one year. Excludes debt issuance costs and unamortized discount of \$4.1 million and \$4.5 million at December 31, 2016 and 2015, respectively.

**b. Recurring Fair Value Measurements.**

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

<i>(In thousands)</i>	Fair Value as of December 31, 2016			
	Total	Level 1	Level 2	Level 3
<b>MGE Energy</b>				
<i>Assets:</i>				
Derivatives, net .....	\$ 1,527	\$ 1,041	\$ -	\$ 486
Exchange-traded investments.....	500	500	-	-
Total Assets .....	<u>\$ 2,027</u>	<u>\$ 1,541</u>	<u>\$ -</u>	<u>\$ 486</u>
<i>Liabilities:</i>				
Derivatives, net .....	\$ 50,808	\$ 16	\$ -	\$ 50,792
Deferred compensation .....	3,039	-	3,039	-
Total Liabilities.....	<u>\$ 53,847</u>	<u>\$ 16</u>	<u>\$ 3,039</u>	<u>\$ 50,792</u>
<b>MGE</b>				
<i>Assets:</i>				
Derivatives, net .....	\$ 1,527	\$ 1,041	\$ -	\$ 486
Exchange-traded investments.....	143	143	-	-
Total Assets .....	<u>\$ 1,670</u>	<u>\$ 1,184</u>	<u>\$ -</u>	<u>\$ 486</u>
<i>Liabilities:</i>				
Derivatives, net .....	\$ 50,808	\$ 16	\$ -	\$ 50,792
Deferred compensation .....	3,039	-	3,039	-
Total Liabilities.....	<u>\$ 53,847</u>	<u>\$ 16</u>	<u>\$ 3,039</u>	<u>\$ 50,792</u>

<i>(In thousands)</i>	Fair Value as of December 31, 2015			
	Total	Level 1	Level 2	Level 3
<b>MGE Energy</b>				
Assets:				
Derivatives, net .....	\$ 234	\$ -	\$ -	\$ 234
Exchange-traded investments.....	759	759	-	-
Total Assets .....	<u>\$ 993</u>	<u>\$ 759</u>	<u>\$ -</u>	<u>\$ 234</u>
Liabilities:				
Derivatives, net <sup>(b)</sup> .....	\$ 54,316	\$ 581	\$ -	\$ 53,735
Deferred compensation .....	3,145	-	3,145	-
Total Liabilities.....	<u>\$ 57,461</u>	<u>\$ 581</u>	<u>\$ 3,145</u>	<u>\$ 53,735</u>
<b>MGE</b>				
Assets:				
Derivatives, net .....	\$ 234	\$ -	\$ -	\$ 234
Exchange-traded investments.....	148	148	-	-
Total Assets .....	<u>\$ 382</u>	<u>\$ 148</u>	<u>\$ -</u>	<u>\$ 234</u>
Liabilities:				
Derivatives, net <sup>(b)</sup> .....	\$ 54,316	\$ 581	\$ -	\$ 53,735
Deferred compensation .....	3,145	-	3,145	-
Total Liabilities.....	<u>\$ 57,461</u>	<u>\$ 581</u>	<u>\$ 3,145</u>	<u>\$ 53,735</u>

(b) These amounts are shown gross and exclude \$1.0 million of collateral that was posted against derivative positions with counterparties as of December 31, 2015.

No transfers were made in or out of Level 1 or Level 2 for the year ended December 31, 2016.

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

Derivatives include exchange-traded derivative contracts, over-the-counter transactions, a 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 considered unobservable and classified as Level 3. Transactions done with an over-the-counter party are on inactive markets and are therefore classified as Level 3. These transactions are valued based on quoted prices from markets with similar exchange-traded transactions. FTRs are priced based upon monthly auction results for identical or similar instruments in a closed market with limited data available and are therefore classified as Level 3.

The purchased power agreement (see Footnote 15) 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.

The following table presents the significant unobservable inputs used in the pricing model as of December 31:

Significant Unobservable Inputs	Model Input	
	2016	2015
Basis adjustment:		
On peak.....	91.9%	96.9%
Off peak.....	93.4%	95.1%
Counterparty fuel mix:		
Internal generation.....	55%-75%	60%-75%
Purchased power.....	45%-25%	40%-25%

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

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

(In thousands)	2016	2015	2014
Balance as of January 1.....	\$ (53,501)	\$ (53,986)	\$ (64,628)
Realized and unrealized gains (losses):			
Included in regulatory liabilities.....	3,195	484	10,642
Included in other comprehensive income.....	-	-	-
Included in earnings.....	(5,347)	(6,635)	5,129
Included in current assets.....	(142)	-	-
Purchases.....	23,346	23,052	26,382
Sales.....	-	-	-
Issuances.....	-	-	-
Settlements.....	(17,857)	(16,416)	(31,511)
Transfers in and/or out of Level 3.....	-	-	-
Balance as of December 31.....	<u>\$ (50,306)</u>	<u>\$ (53,501)</u>	<u>\$ (53,986)</u>
Total gains (losses) included in earnings attributed to the change in unrealized gains (losses) related to assets and liabilities held at December 31, <sup>(c)</sup> .....	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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 (c).

(In thousands)	2016	2015	2014
<b>Year Ended December 31,</b>			
Purchased power expense.....	\$ (5,262)	\$ (6,663)	\$ 5,137
Cost of gas sold expense.....	(85)	28	(8)
Total.....	<u>\$ (5,347)</u>	<u>\$ (6,635)</u>	<u>\$ 5,129</u>

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

## 12. Income Taxes.

### a. MGE Energy and MGE Income Taxes.

MGE Energy files a consolidated federal income tax return that includes the operations of all subsidiary companies. The subsidiaries calculate their respective federal income tax provisions as if they were separate taxable entities.

On a consolidated and separate company basis, the income tax provision consists of the following provision (benefit) components for the years ended December 31:

<i>(In thousands)</i>	MGE Energy			MGE		
	2016	2015	2014	2016	2015	2014
Current payable:						
Federal .....	\$ 16,908	\$ 16,837	\$ (891)	\$ 17,521	\$ 19,295	\$ 637
State .....	3,287	2,774	(589)	3,497	3,443	(451)
Net-deferred:						
Federal .....	17,571	15,951	39,284	16,391	13,538	38,553
State .....	4,850	5,976	10,600	4,485	5,305	10,625
Amortized investment tax credits....	(103)	(175)	(219)	(103)	(175)	(219)
Total income tax provision.....	\$ 42,513	\$ 41,363	\$ 48,185	\$ 41,791	\$ 41,406	\$ 49,145

The consolidated income tax provision differs from the amount computed by applying the statutory federal income tax rate to income before income taxes, as follows:

	MGE Energy			MGE		
	2016	2015	2014	2016	2015	2014
Statutory federal income tax rate .....	35.0 %	35.0 %	35.0 %	35.0 %	35.0 %	35.0 %
State income taxes, net of federal benefit ....	5.1 %	5.2 %	5.1 %	5.1 %	5.2 %	5.1 %
Amortized investment tax credits .....	(0.1)%	(0.2)%	(0.2)%	(0.1)%	(0.2)%	(0.2)%
Credit for electricity from wind energy .....	(1.6)%	(1.8)%	(1.7)%	(1.7)%	(1.8)%	(1.7)%
Domestic manufacturing deduction .....	(1.3)%	(1.4)%	-%	(1.3)%	(1.4)%	-%
AFUDC equity, net.....	(0.2)%	(0.1)%	(0.8)%	(0.2)%	(0.1)%	(0.8)%
Other, net, individually insignificant.....	(0.9)%	-%	0.1 %	(0.9)%	-%	0.1 %
Effective income tax rate.....	36.0 %	36.7 %	37.5 %	35.9 %	36.7 %	37.5 %

The significant components of deferred tax liabilities (assets) that appear on the consolidated balance sheets as of December 31 are as follows:

<i>(In thousands)</i>	MGE Energy		MGE	
	2016	2015	2016	2015
Property-related .....	\$ 344,721	\$ 327,918	\$ 344,630	\$ 327,822
Investment in ATC <sup>(a)</sup> .....	71,898	38,213	-	30,382
Bond transactions.....	1,324	1,422	1,324	1,422
Pension and other postretirement benefits .....	63,516	57,697	63,516	57,697
Derivatives .....	20,304	21,660	20,304	21,660
Tax deductible prepayments .....	8,404	8,011	8,404	8,011
Other .....	16,606	14,997	16,571	14,831
Gross deferred income tax liabilities.....	526,773	469,918	454,749	461,825
Investment in ATC <sup>(a)</sup> .....	(31,212)	-	-	-
Accrued expenses .....	(22,410)	(21,391)	(22,410)	(21,391)
Pension and other postretirement benefits .....	(48,860)	(46,582)	(48,860)	(46,582)
Deferred tax regulatory account.....	(903)	(1,047)	(903)	(1,047)
Derivatives .....	(20,304)	(21,660)	(20,304)	(21,660)
Other .....	(19,340)	(18,523)	(19,224)	(18,589)
Gross deferred income tax assets.....	(143,029)	(109,203)	(111,701)	(109,269)
Less valuation allowance.....	69	70	69	70
Net deferred income tax assets .....	(142,960)	(109,133)	(111,632)	(109,199)
Deferred income taxes .....	\$ 383,813	\$ 360,785	\$ 343,117	\$ 352,626

(a) As of December 1, 2016, MGE transferred its ownership interest in ATC to MGE Energy, resulting in a deferred intercompany gain and a corresponding step-up in tax basis.

Our state valuation allowance reduces MGE Energy's and MGE's deferred tax assets for state carryforward losses to estimated realizable value due to the uncertainty of future income estimates in various state tax jurisdictions. For tax purposes, as of December 31, 2016, both MGE Energy and MGE had approximately \$1.4 million of state tax net operating loss deductions subject to a valuation allowance that expire between 2020 and 2023 if unused.

**b. Accounting for Uncertainty in Income Taxes - MGE Energy and MGE.**

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.

A tabular reconciliation of unrecognized tax benefits and interest from January 1, 2014, to December 31, 2016, is as follows:

*(In thousands)*

<b>Unrecognized Tax Benefits:</b>	2016	2015	2014
Unrecognized tax benefits, January 1, .....	\$ 2,528	\$ 2,365	\$ 2,363
Additions based on tax positions related to the current year .....	452	488	610
Additions based on tax positions related to the prior years .....	39	520	618
Reductions based on tax positions related to the prior years .....	(532)	(845)	(1,226)
Unrecognized tax benefits, December 31, .....	<u>\$ 2,487</u>	<u>\$ 2,528</u>	<u>\$ 2,365</u>

*(In thousands)*

<b>Interest on Unrecognized Tax Benefits:</b>	2016	2015	2014
Accrued interest on unrecognized tax benefits, January 1, .....	\$ 311	\$ 92	\$ 101
Reduction in interest expense on uncertain tax positions.....	(27)	(102)	(97)
Interest expense on uncertain tax positions.....	104	321	88
Accrued interest on unrecognized tax benefits, December 31, .....	<u>\$ 388</u>	<u>\$ 311</u>	<u>\$ 92</u>

Unrecognized tax benefits are liabilities shown with "Other deferred liabilities" on the consolidated balance sheets. The interest component is offset by a regulatory asset.

At December 31, 2016, 2015, and 2014, MGE Energy and MGE had unrecognized tax benefits primarily related to temporary tax differences associated with the change in income tax method of accounting for electric generation and electric and gas distribution repairs. In addition, at December 31, 2016, MGE Energy and MGE had unrecognized tax benefits relating to permanent differences and tax credits of less than \$0.1 million. There were no unrecognized tax benefits at December 31, 2015 or 2014, related to federal permanent differences and tax credits.

The unrecognized tax benefits at December 31, 2016, are not expected to significantly increase or decrease within the next twelve months. In addition, statutes of limitations will expire for MGE Energy and MGE tax returns. The impact of the statutes of limitations expiring is not anticipated to be material. The following table shows tax years that remain subject to examination by major jurisdiction:

<b>Taxpayer</b>	<b>Open Years</b>
MGE Energy and consolidated subsidiaries in federal return .....	2013 through 2016
MGE Energy Wisconsin combined reporting corporation return .....	2012 through 2016

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

MGE maintains qualified and nonqualified pension plans, health care, and life insurance benefits, and defined contribution 401(k) benefit plans for its employees and retirees. MGE's costs for the 401(k) plans were \$3.1 million, \$2.8 million, and \$2.5 million in 2016, 2015, and 2014, respectively. A measurement date of December 31 is utilized for all pension and postretirement benefit plans.

All employees hired after December 31, 2006, have been enrolled in the defined contribution pension plan, rather than the defined benefit pension plan previously in place.

**a. Benefit Obligations and Plan Assets.**

<i>(In thousands)</i>	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
<b>Change in Benefit Obligations:</b>				
Net benefit obligation at beginning of year .....	\$ 332,565	\$ 340,233	\$ 74,935	\$ 78,478
Service cost.....	5,365	7,263	1,271	1,559
Interest cost.....	12,393	13,766	2,681	3,075
Plan participants' contributions.....	-	-	767	741
Actuarial loss (gain) <sup>(a)</sup> .....	11,412	(17,576)	2,638	(5,828)
Gross benefits paid.....	(12,179)	(11,121)	(3,637)	(3,280)
Less: federal subsidy on benefits paid <sup>(b)</sup> .....	-	-	187	190
Benefit obligation at end of year.....	\$ <u>349,556</u>	\$ <u>332,565</u>	\$ <u>78,842</u>	\$ <u>74,935</u>
<b>Change in Plan Assets:</b>				
Fair value of plan assets at beginning of year .....	\$ 290,716	\$ 288,548	\$ 40,170	\$ 38,952
Actual return on plan assets .....	24,181	4,153	3,236	603
Employer contributions .....	9,215	9,136	2,641	3,154
Plan participants' contributions.....	-	-	767	741
Gross benefits paid.....	(12,179)	(11,121)	(3,637)	(3,280)
Fair value of plan assets at end of year .....	\$ <u>311,933</u>	\$ <u>290,716</u>	\$ <u>43,177</u>	\$ <u>40,170</u>
Funded Status at December 31 .....	\$ <u>(37,623)</u>	\$ <u>(41,849)</u>	\$ <u>(35,665)</u>	\$ <u>(34,765)</u>

(a) In 2016, lower discount rates were the main driver of the actuarial loss.

(b) In 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 was signed into law authorizing Medicare to provide prescription drug benefits to retirees. For the years ended December 31, 2016 and 2015, the subsidy due to MGE was \$0.2 million.

The accumulated benefit obligation for the defined benefit pension plans at the end of 2016 and 2015 was \$319.9 million and \$302.5 million, respectively.

The amounts recognized in the consolidated balance sheets to reflect the funded status of the plans at December 31 are as follows:

<i>(In thousands)</i>	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
Long-term asset.....	\$ 2,020	\$ -	\$ -	\$ -
Current liability .....	(972)	(966)	-	(52)
Long-term liability.....	(38,671)	(40,883)	(35,665)	(34,713)
Net liability.....	\$ <u>(37,623)</u>	\$ <u>(41,849)</u>	\$ <u>(35,665)</u>	\$ <u>(34,765)</u>

The following table shows the amounts that have not yet been recognized in our net periodic benefit cost as of December 31 and are recorded as regulatory assets in our consolidated balance sheets:

<i>(In thousands)</i>	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
Net actuarial loss .....	\$ 84,656	\$ 80,660	\$ 14,728	\$ 13,086
Prior service benefit.....	(446)	(436)	(12,489)	(15,158)
Transition obligation .....	-	-	26	29
Total.....	\$ <u>84,210</u>	\$ <u>80,224</u>	\$ <u>2,265</u>	\$ <u>(2,043)</u>

The projected benefit obligation and fair value of plan assets for pension plans with a projected benefit obligation in excess of plan assets were as follows:

	Pension Benefits	
	2016	2015
<i>(In thousands)</i>		
<b>Projected Benefit Obligation in Excess of Plan Assets</b>		
Projected benefit obligation, end of year.....	\$ 227,739	\$ 332,565
Fair value of plan assets, end of year.....	188,096	290,716

The accumulated benefit obligation and fair value of plan assets for pension plans with an accumulated benefit obligation in excess of plan assets were as follows:

	Pension Benefits	
	2016	2015
<i>(In thousands)</i>		
<b>Accumulated Benefit Obligation in Excess of Plan Assets</b>		
Accumulated benefit obligation, end of year.....	\$ 26,927	\$ 24,606
Fair value of plan assets, end of year.....	-	-

#### b. Net Periodic Cost.

	Pension Benefits			Other Postretirement Benefits		
	2016	2015	2014	2016	2015	2014
<i>(In thousands)</i>						
<b>Components of Net Periodic Cost (Benefit):</b>						
Service cost .....	\$ 5,365	\$ 7,263	\$ 6,179	\$ 1,271	\$ 1,559	\$ 1,339
Interest cost .....	12,393	13,766	13,574	2,681	3,075	3,166
Expected return on assets .....	(22,365)	(22,682)	(22,051)	(2,829)	(2,812)	(2,615)
Amortization of:						
Transition obligation .....	-	-	-	3	3	3
Prior service cost (benefit) .....	10	23	204	(2,669)	(2,669)	(2,669)
Actuarial loss .....	5,600	5,395	703	589	953	252
Net periodic cost (benefit) .....	\$ 1,003	\$ 3,765	\$ (1,391)	\$ (954)	\$ 109	\$ (524)

#### c. Plan Assumptions.

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

	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
Discount rate <sup>(a)</sup> .....	4.29%	4.51%	4.11%	4.32%
Rate of compensation increase .....	3.71%	3.78%	N/A	N/A
Assumed health care cost trend rates:				
Health care cost trend rate assumed for next year ..	N/A	N/A	6.25%	6.5%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) .....	N/A	N/A	5.0%	5.0%
Year that the rate reaches the ultimate trend rate .....	N/A	N/A	2022	2022

(a) In 2015, MGE refined its methodology for using discount rates to measure the components of net periodic benefit cost. The refined methodology uses individual spot rates, instead of a weighted average of the yield curve spot rates, for measuring the service cost and interest cost components.

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

	Pension Benefits			Other Postretirement Benefits		
	2016	2015	2014	2016	2015	2014
Discount rate .....	4.51%	4.11%	4.88%	4.32%	3.96%	4.69%
Expected rate of return on plan assets .....	7.65%	7.80%	8.10%	6.96%	7.06%	7.07%
Rate of compensation increase .....	3.76%	3.84%	3.93%	N/A	N/A	N/A

The assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The following table shows how an assumed 1% increase or 1% decrease in health care cost trends could impact postretirement benefits in 2016 dollars:

<i>(In thousands)</i>	<u>1% Increase</u>	<u>1% Decrease</u>
Effect on other postretirement benefit obligation	\$ 1,175	\$ (1,479)
Effect on total service and interest cost components	54	(67)

MGE employs a building-block approach in determining the expected long-term rate of return for asset classes. Historical markets are studied and long-term historical relationships among asset classes are analyzed, consistent with the widely accepted capital market principle that assets with higher volatility generate a greater return over the long run. Current market factors, such as interest rates and dividend yields, are evaluated before long-term capital market assumptions are determined.

The expected long-term nominal rate of return for plan assets is primarily a function of expected long-term real rates of return for component asset classes and the plan's target asset allocation in conjunction with an inflation assumption. Peer data and historical returns are reviewed to check for appropriateness.

**d. Investment Strategy.**

MGE employs a total return investment approach whereby a mix of equities, fixed income, and real estate investments are used to maximize the expected long-term return of plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan-funded status, and corporate financial condition. The investment portfolio contains a diversified blend of equity, fixed income, and real estate investments. Investment risk is measured and monitored on an ongoing basis through periodic investment portfolio reviews and liability measurements.

The asset allocation for MGE's pension plans at the end of 2016 and 2015, and the target allocation for 2017, by asset category, follows:

	Target Allocation	Percentage of Plan Assets at Year End	
		2016	2015
Equity securities <sup>(a)</sup> .....	63.0 %	65.0 %	63.0 %
Fixed income securities .....	30.0 %	27.0 %	29.0 %
Real estate .....	7.0 %	8.0 %	8.0 %
Total .....	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

(a) Target allocations for equity securities are broken out as follows: 45.5% United States equity, 17.5% non-United States equity.

The fair value of plan assets for the postretirement benefit plans is \$43.2 million and \$40.2 million at the end of 2016 and 2015, respectively. Of this amount, \$37.0 million and \$34.1 million at the end of 2016 and 2015, respectively, were held in the master pension trust and are allocable to postretirement health expenses. The target asset allocation and investment strategy for the portion of assets held in the master pension trust are the same as that explained for MGE's pension plans. The remainder of postretirement benefit assets are held either in an insurance continuance fund for the payment of retiree life benefits or health benefit trusts for payment of retiree health premiums. The asset allocation for the insurance continuance fund is determined by the life insurer. The target asset allocation for the health benefit trusts are established based on a similar investment strategy as assets held in the master pension trust, with consideration for liquidity needs in the health benefit trusts.

**e. Concentrations of Credit Risk.**

MGE evaluated its pension and other postretirement benefit plans' asset portfolios for the existence of significant concentrations of credit risk as of December 31, 2016. Types of concentrations that were evaluated include, but are not limited to, investment concentrations in a single entity, type of industry, and foreign country. As of December 31, 2016, there were no significant concentrations (defined as greater than 10 percent of plan assets) of risk in MGE pension and postretirement benefit plan assets.

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**f. Fair Value Measurements of Plan Assets.**

Pension and other postretirement benefit plan investments are recorded at fair value. See Footnote 11 for more information regarding the fair value hierarchy.

The following descriptions are the categories of underlying plan assets held within the pension and other postretirement benefit plans as of December 31, 2016:

Cash and Cash Equivalents – This category includes highly liquid investments with maturities of less than three months which are traded in active markets.

Equity Securities – These securities consist of U.S. and international stock funds. The U.S. stock funds are primarily invested in domestic equities. Securities in these funds are typically priced using the closing price from the applicable exchange, NYSE, Nasdaq, etc. The international funds are composed of international equities. Securities are priced using the closing price from the appropriate local stock exchange.

Fixed Income Securities – These securities consist of U.S. bond funds and short-term funds. U.S. bond funds are priced by a pricing agent using inputs such as benchmark yields, reported trades, broker/dealer quotes, and issuer spreads. The short-term funds are valued initially at cost and adjusted for amortization of any discount or premium.

Real Estate – The fair value of real estate properties is determined through an external appraisal process.

Insurance Continuance Fund (ICF) – The ICF is a supplemental retirement plan that includes assets that have been segregated and restricted to pay retiree term life insurance premiums.

Fixed Rate Fund – The Fixed Rate fund is supported by an underlying portfolio of fixed income securities, including public bonds, commercial mortgages, and private placement bonds. Public market data and GAAP reported market values are used when available to determine fair value.

All of the fair values of MGE's plan assets are measured using net asset value, except for cash and cash equivalents which are considered level 1 investments. The fair values of MGE's plan assets by asset category are as follows:

<i>(In thousands)</i>	2016	2015
Cash and Cash Equivalents .....	\$ 284	\$ 300
Equity Securities:		
U.S. Large Cap .....	107,406	98,949
U.S. Mid Cap.....	25,966	22,446
U.S. Small Cap .....	33,836	27,561
International Blend.....	59,054	55,948
Fixed Income Securities:		
Short-Term Fund.....	4,318	3,388
High Yield Bond.....	17,978	16,225
Long Duration Bond.....	71,512	73,112
Real Estate .....	29,441	27,231
Insurance Continuance Fund .....	1,514	1,518
Fixed Rate Fund .....	3,801	4,208
Total .....	<u>\$ 355,110</u>	<u>\$ 330,886</u>

**g. Expected Cash Flows.**

Contributions to the qualified plans for 2017 were \$6.0 million, which was paid in January 2017. MGE does not expect to make contributions to the plans for 2018. The contributions for years after 2018 are not yet currently estimated. MGE has adopted the asset smoothing as permitted in accordance with the Pension Protection Act of 2006, including modifications made by WRERA.

Due to uncertainties in the future economic performance of plan assets, discount rates, and other key assumptions, estimated contributions are subject to change. MGE may also elect to make additional discretionary contributions.

In 2016, MGE made \$14.5 million in employer contributions to its pension and postretirement plans.

## h. Benefit Payments.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

<i>(In thousands)</i>	Pension		Other Postretirement Benefits		
	Pension Benefits	Gross Postretirement Benefits	Expected Medicare Part D Subsidy	Net Postretirement Benefits	
2017	\$ 13,468	\$ 3,623	\$ (232)	\$ 3,391	
2018	14,618	3,998	(252)	3,746	
2019	15,632	4,442	(274)	4,168	
2020	16,429	4,932	(302)	4,630	
2021	17,263	5,442	(326)	5,116	
2022 - 2026	99,725	31,065	(2,122)	28,943	

## 14. Share-Based Compensation - MGE Energy and MGE.

Under MGE Energy's Director Incentive Plan and Performance Unit Plan, non-employee directors and eligible employees 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 accordance with the plans' provisions, these awards are subject to prescribed vesting schedules and must be settled in cash. Accordingly, no shares of common stock will be issued in connection with the plans.

On the grant date, MGE Energy and MGE measure the cost of the director or employee services received in exchange for a performance unit award based on the current market value of MGE Energy common stock. The fair value of the awards is re-measured quarterly, including at December 31, 2016, as required by applicable accounting standards. Changes in fair value as well as the original grant are recognized as compensation cost. Since this amount is re-measured throughout the vesting period, the compensation cost is subject to variability.

Units granted under the Director Incentive Plan are subject to a three-year vesting schedule. The most recent three years of units granted under this plan are as follows:

<u>Grant Date</u>	<u>MGE Energy Units Granted</u>
January 20, 2017 .....	4,032
January 15, 2016 .....	3,773
January 16, 2015 .....	3,794

Units granted under the Performance Unit Plan are subject to a five-year vesting schedule. The most recent units granted under this plan are as follows:

<u>Grant Date</u>	<u>MGE Energy Units Granted</u>
February 19, 2016 .....	19,055
February 20, 2015 .....	18,948
February 21, 2014 .....	21,991
February 15, 2013 .....	22,884

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.

During the years ended December 31, 2016, 2015, and 2014, MGE recorded \$3.1 million, \$1.0 million, and \$2.0 million, respectively, in compensation expense as a result of awards under the plans. In January 2016, cash payments of \$1.2 million were distributed relating to awards that were granted in 2011. During the year ended December 31, 2015, MGE recorded a \$0.2 million gain on 4,676 units forfeited. No forfeitures occurred during the years ended December 31, 2016 and 2014. At December 31, 2016, \$6.9 million of outstanding awards are vested, and of this amount, no cash settlements have occurred.

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**15. 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. 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. MGE's financial commodity 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:

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Commodity derivative contracts .....	393,395 MWh	355,580 MWh
Commodity derivative contracts .....	4,195,000 Dth	5,037,500 Dth
FTRs .....	2,251 MW	2,000 MW
PPA.....	3,250 MW	3,850 MW

**c. Financial Statement Presentation.**

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 electricity 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 offset with a corresponding 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 December 31, 2016, the fair value of exchange traded derivatives and FTRs exceeded their cost basis by \$1.3 million. At December 31, 2015, the cost basis of exchange traded derivatives and FTRs exceeded their fair value by \$0.8 million.

MGE is a party to a purchased power agreement that provides MGE with firm capacity and energy during a base term from June 1, 2012, through May 31, 2022. The agreement also allows MGE an option to extend the contract after the base term. The agreement is accounted for as a derivative contract and is recognized at its fair value on the consolidated balance sheets. 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 December 31, 2016 and 2015, reflects a loss position of \$50.6 million and \$53.3 million, respectively. The actual 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 consolidated balance sheets. All derivative instruments in this table are presented on a gross basis and are calculated prior to the netting of instruments with the same counterparty under a master netting agreement as well as the netting of collateral. For financial statement purposes, MGE Energy and MGE have netted instruments with the same counterparty under a master netting agreement as well as the netting of collateral.

<i>(In thousands)</i>	Derivative Assets	Derivative Liabilities	Balance Sheet Location
<b>December 31, 2016</b>			
Commodity derivative contracts <sup>(a)</sup> ..... \$	1,227	\$ 164	Other current assets
Commodity derivative contracts <sup>(a)</sup> .....	157	54	Other deferred charges
FTRs .....	143	-	Other current assets
PPA.....	N/A	7,620	Derivative liability (current)
PPA.....	N/A	42,970	Derivative liability (long-term)
<b>December 31, 2015</b>			
Commodity derivative contracts <sup>(a)</sup> ..... \$	146	\$ 1,266	Derivative liability (current)
Commodity derivative contracts <sup>(a)</sup> .....	144	70	Derivative liability (long-term)
FTRs .....	234	-	Other current assets
PPA.....	N/A	8,340	Derivative liability (current)
PPA.....	N/A	44,930	Derivative liability (long-term)

(a) As of December 31, 2015, collateral of \$1.0 million was posted against and netted with derivative liability positions on the consolidated balance sheets. No collateral was posted against derivative positions as of December 31, 2016.

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

#### Offsetting of Derivative Assets

<i>(In thousands)</i>	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
<b>December 31, 2016</b>				
Commodity derivative contracts .... \$	1,384	\$ (218)	\$ -	\$ 1,166
FTRs .....	143	-	-	143
<b>December 31, 2015</b>				
Commodity derivative contracts .... \$	290	\$ (290)	\$ -	-
FTRs .....	234	-	-	234

#### Offsetting of Derivative Liabilities

<i>(In thousands)</i>	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
<b>December 31, 2016</b>				
Commodity derivative contracts .... \$	218	\$ (218)	\$ -	-
PPA .....	50,590	-	-	50,590
<b>December 31, 2015</b>				
Commodity derivative contracts .... \$	1,336	\$ (290)	\$ (1,038)	8
PPA .....	53,270	-	-	53,270

The following tables summarize the unrealized and realized gains (losses) related to the derivative instruments on the consolidated balance sheets at December 31, 2016 and 2015, and the consolidated income statements for the years ended December 31, 2016 and 2015.

	2016		2015	
	Current and Long-Term Regulatory Asset	Other Current Assets	Current and Long-Term Regulatory Asset	Other Current Assets
<i>(In thousands)</i>				
Balance at January 1, .....	\$ 54,082	\$ 1,208	\$ 54,998	\$ 1,001
Unrealized loss .....	1,575	-	8,586	-
Realized (loss) gain reclassified to a deferred account ...	(1,060)	1,060	(2,953)	2,953
Realized loss reclassified to income statement .....	(5,316)	(2,038)	(6,549)	(2,746)
Balance at December 31, .....	<u>\$ 49,281</u>	<u>\$ 230</u>	<u>\$ 54,082</u>	<u>\$ 1,208</u>

	Realized Losses (Gains)			
	2016		2015	
<i>(In thousands)</i>	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold
	<b>Year Ended December 31:</b>			
Commodity derivative contracts .....	\$ 1,154	\$ 2,064	\$ 2,236	\$ 2,548
FTRs .....	(445)	-	(309)	-
PPA .....	4,581	-	4,820	-

MGE's commodity derivative contracts, FTRs, and PPA are subject to regulatory deferral. These derivatives are marked to fair value and are offset with a corresponding regulatory asset or liability. Realized gains and losses are deferred on the consolidated balance sheets 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 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 December 31, 2016, no collateral is required to be, or 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 December 31, 2016, no counterparties were in a net liability position. As of December 31, 2015, certain counterparties were in a net liability of less than \$0.1 million.

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 December 31, 2016, no counterparties have defaulted.

## 16. Rate Matters - MGE Energy and MGE.

### a. Rate Proceedings.

On December 15, 2016, the PSCW authorized MGE to decrease 2017 rates for retail electric customers by 0.8% or \$3.3 million and to increase rates for retail gas customers by 1.9% or \$3.1 million. The decrease in retail electric rates is attributable to declining fuel and purchased power costs. The increase in retail gas rates covers costs associated with MGE's natural gas system infrastructure improvements. The authorized return on common stock equity for 2017 is 9.8% on 57.2% common equity. The PSCW also approved MGE's request to extend the current accounting treatment for transmission related costs through 2018.

In July 2015, the PSCW approved MGE's request to extend the current accounting treatment for transmission related costs through 2016, conditioned upon MGE not filing a base rate case for 2016. This accounting treatment allows MGE to reflect any differential between transmission costs reflected in rates and actual costs incurred in its next rate case filing.

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On December 23, 2014, the PSCW authorized MGE to increase 2015 rates for retail electric customers by 3.8% or \$15.4 million and to decrease gas rates by 2.0% or \$3.8 million. The increase in retail electric rates cover costs associated with the construction of emission-reduction equipment at Columbia, improvements and reliability of the state's electric transmission system, fuel and purchased power related to coal delivery costs, partially offset by lower cost as a result of market conditions for pension and postretirement benefit costs. The authorized return on common stock equity was 10.2%.

The PSCW also approved changes to customer rates and rate design for gas service that became effective January 1, 2015. Gas rate design consists of a fixed monthly customer charge and a variable charge tied to actual usage, in addition to the separate charge through the PGA for natural gas commodity costs. The change shifted more of the rate recovery to the monthly charge, reflecting the related fixed costs of providing gas services, and reduced the variable usage-based charge. Thus, gas net income is expected to be more evenly distributed during the year and less sensitive to weather.

On July 26, 2013, the PSCW authorized MGE to freeze electric and natural gas rates at 2013 levels for 2014. The order authorized 100% AFUDC on the Columbia scrubber construction project and deferral of increased costs related to ATC and MISO network upgrade fees. As part of the rate freeze plan authorized by the PSCW, effective January 1, 2014, approximately \$6.3 million associated with a 2012 fuel rule surplus credit was amortized in 2014. The fuel credit accrued interest at MGE's weighted cost of capital. The authorized return on common stock equity was unchanged at 10.3%.

**b. Fuel Rules.**

Fuel rules require the PSCW and Wisconsin utilities to defer electric fuel-related costs that fall outside a symmetrical cost tolerance band around the amount approved for a utility in its annual fuel proceedings. Any over/under recovery of the actual costs in a year is determined in the following year and is then reflected in future billings to electric retail customers. The fuel rules bandwidth is currently set at plus or minus 2%. Under fuel rules, MGE would defer costs, less any excess revenues, if its actual electric fuel costs exceeded 102% of the electric fuel costs allowed in its latest rate order. Excess revenues are defined as revenues in the year in question that provide MGE with a greater return on common equity than authorized by the PSCW in MGE's latest rate order. Conversely, MGE is required to defer the benefit of lower costs if actual electric fuel costs were less than 98% of the electric fuel costs allowed in that order.

In August 2015, the PSCW approved a \$0.00256/kWh fuel credit that began on September 1, 2015, and continued throughout 2016. The fuel credit established a mechanism to return \$10.9 million of fuel savings to electric customers as a bill credit. MGE returned \$2.6 million of electric fuel-related savings to customers through bill credits during the period from September 1, 2015, through December 31, 2015. MGE returned \$8.3 million of electric fuel-related savings during the year ended December 31, 2016.

In January 2016, the PSCW lowered MGE's 2016 fuel rules monitored costs by \$14.8 million as a result of continued lower projected fuel costs in 2016. Also, in March 2016, MGE filed its 2015 fuel plan reconciliation application showing an overcollection of 2015 fuel rules monitored costs. In July 2016, the PSCW issued a final order stating that MGE shall refund the additional fuel savings incurred during 2015 and 2016 for a total of \$15.7 million to its retail electric customers over a one-month period. In September 2016, MGE returned \$15.5 million to customers through bill credits.

As of December 31, 2016, MGE has deferred \$5.6 million of 2016 fuel savings that were in excess of the fuel savings included within the fuel credits referenced above. These costs will be subject to the PSCW's annual review of 2016 fuel costs, expected to be completed in 2017.

## 17. Commitments and Contingencies.

### a. 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 December 31, 2016, the future minimum commitments related to these purchase contracts were as follows:

<i>(In thousands)</i>	2017	2018	2019	2020	2021	Thereafter
Coal <sup>(a)</sup> .....	\$ 21,246	\$ 14,763	\$ 7,281	\$ -	\$ -	\$ -
Natural gas .....						
Transportation and storage <sup>(b)</sup> ..	20,859	20,645	19,483	15,226	8,443	23,331
Supply <sup>(c)</sup> .....	17,783	-	-	-	-	-
Purchase power <sup>(d)</sup> .....	48,056	46,563	33,670	32,577	33,266	66,231
Other .....	14,902	324	143	-	-	-
	<u>\$ 122,846</u>	<u>\$ 82,295</u>	<u>\$ 60,577</u>	<u>\$ 47,803</u>	<u>\$ 41,709</u>	<u>\$ 89,562</u>

- (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 is handled by WPL and WEPCO, respectively, who are the operators of those facilities. If any minimum purchase obligations must be paid under these contracts, management believes these obligations would be considered costs of service and recoverable in rates.
- (b) MGE's natural gas transportation and storage contracts require fixed monthly payments for firm supply pipeline transportation and storage capacity. The pricing components of the fixed monthly payments for the transportation and storage contracts are established by FERC but may be subject to change. Management expects to recover these costs in future customer rates.
- (c) These commitments include market-based pricing. Management expects to recover these costs in future customer rates.
- (d) MGE has several purchase power agreements to help meet future electric supply requirements. Management expects to recover these costs in future customer rates. In October 2008, MGE entered into a purchase power agreement to help meet future electric supply requirements. Under this agreement, MGE has agreed to purchase 50 MW of wind power from Osceola Windpower II, LLC, which is located in Iowa. This facility became operational in October 2008. MGE does not have any capacity payment commitments under this agreement. However, MGE is obligated to purchase its ratable share of the energy produced by the project. MGE's commitment related to its ratable share of energy produced by the project has been estimated and is included in the above numbers. Management expects to recover these costs in future customer rates.

### b. Leases - MGE Energy and MGE.

MGE has noncancelable operating leases, primarily for combustion turbines, railcars, and computer equipment. The operating leases generally do not contain renewal options, with the exception of certain railcar operating leases. These leases have a renewal option of one year or less. MGE is required to pay all executory costs, such as maintenance and insurance, for its leases.

Future minimum rental payments at December 31, 2016, under agreements classified as operating leases with noncancelable terms in excess of one year are as follows:

<i>(In thousands)</i>	2017	2018	2019	2020	2021	Thereafter
Minimum lease payments .....	\$ 1,331	\$ 959	\$ 441	\$ 310	\$ 278	\$ 8,020

Rental expense under operating leases totaled \$2.0 million, \$2.1 million, and \$2.5 million for 2016, 2015, and 2014, respectively.

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c. **Environmental - MGE Energy and MGE.**

**Water Quality**

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

**EPA's Effluent Limitations Guidelines (ELG) and Standards for Steam Electric Power Generating Point Source Category**

In November 2015, the EPA published its final rule setting Effluent Limitations Guidelines (ELG) for the steam electric power generating industry. The ELG rule establishes federal limits on the amount of metals and other pollutants that can be discharged in wastewater from new and existing steam electric generation plants. The ELG rule mostly covers pollutants that are captured by certain air pollution control systems and via wet ash handling systems at coal-burning power plants with units greater than 50 MW generation capacity. The operators of our Columbia and Elm Road Units have indicated that equipment upgrades may be necessary to comply with the new discharge standards. The rule will be applied to Wisconsin-based power plants as they renew their WPDES permits, beginning in 2018 but no later than 2023. Management believes that any compliance costs will be recovered in future rates based on previous treatment of environmental compliance projects.

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

Section 316(b) of the Clean Water Act requires that the cooling water intake structures at electric power plants meet best available technology standards so that mortality from entrainment (drawing aquatic life into a plant's cooling system) and impingement (trapping aquatic life on screens) are reduced. The EPA finalized its 316(b) rule for existing facilities in 2014. Section 316(b) requirements are implemented in Wisconsin through modifications to plants' WPDES permits, which govern plant wastewater discharges. The WDNR is currently developing guidance and rules to implement the EPA 316(b) rule.

Our WCCF, Blount, and Columbia plants are considered existing plants under this rule. Our WCCF facility already employs a system that meets the 316(b) rule. Our Blount plant has conducted historical studies that will show that it will likely be in compliance with this rule when its WPDES permit is renewed in 2017. The operator of our Columbia plant is conducting an intake study to demonstrate compliance with the 316(b) rule and/or identify design criteria needed to meet the new rule requirements prior to Columbia's 2017 WPDES permit renewal. The exact requirements at Blount and Columbia, however, will not be known until the WDNR finalizes its rule, approves the plant operators' approach, and those sites' WPDES permits are modified to account for this rule. Nonetheless, MGE expects that the 316(b) rule will not have material effects on its existing plants.

**Energy Efficiency and Renewables**

The Wisconsin Energy Efficiency and Renewables Act requires that 10% of the state's electricity be generated from renewable sources. MGE is in compliance with the requirement. The costs to comply with the Act and its accompanying regulations are being recovered in rates.

**Air Quality**

Federal and state air quality regulations impose restrictions on various emissions including emissions of particulate matter (PM), sulfur dioxide (SO<sub>2</sub>), nitrogen oxides (NO<sub>x</sub>), and other pollutants, and require permits for operation of emission sources. These permits have been obtained by MGE and must be renewed periodically. Current EPA initiatives under the Clean Air Act, including a recent update to the Cross-State Air Pollution Rule (CSAPR), and recently revised National Ambient Air Quality Standards (NAAQS) for ozone have the potential to result in additional operating and capital expenditure costs for MGE.

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*EPA's Greenhouse Gas (GHG) Reduction Guidelines under the Clean Air Act 111(d) Rule*

In October 2015, the EPA finalized its Clean Power Plan (CPP) rule with an effective date of December 2015, setting guidelines and approval criteria for states to use in developing plans to control GHG emissions from existing fossil fuel-fired electric generating units (EGUs) and systems. Implementation of the rule is expected to have a direct impact on existing coal and natural gas fired generating units, including possible changes in dispatch and additional operating costs.

In October 2015, many states (including Wisconsin) and other litigants filed petitions with the U.S. Court of Appeals for the District of Columbia Circuit asking for a stay of the CPP rule, and seeking expedited review of the petitioners' challenges to the CPP's legality. The parties' request to stay the rule was denied by the D.C. Circuit on January 20, 2016, but the D.C. Circuit issued an expedited schedule for resolving the merits of the litigation. On January 26, 2016, several parties filed a request for a stay of the CPP with the U.S. Supreme Court.

On February 9, 2016, the U.S. Supreme Court issued a stay blocking implementation of the CPP pending the Court's own review. The CPP may not be implemented until the Supreme Court lifts the stay, presumably after the courts ultimately resolve the underlying legality of the rule. Oral arguments were held before the D.C. Circuit in September 2016 and a decision by the D.C. Circuit is expected in 2017.

Given the pending legal proceedings, the nature and timing of any final requirements is subject to uncertainty. If the rule remains substantially in its present form, it is expected to have a material impact on MGE.

*National Ambient Air Quality Standards (NAAQS) and Related Rules*

The EPA's NAAQS regulations have been developed to set ambient levels of six pollutants to protect sensitive human populations (primary NAAQS) and the environment (secondary NAAQS) from the negative effects of exposure to these pollutants at higher levels. The Clean Air Act requires that the EPA periodically review, and adjust as necessary, the NAAQS for these six air pollutants. The EPA's NAAQS review can result in a lowering of the allowed ambient levels of a pollutant, a change in how the pollutant is monitored, and/or a change in which sources of that pollutant are regulated. States implement any necessary monitoring and measurement changes and recommend areas for attainment (meets the ambient requirements) or nonattainment (does not meet these standards). The EPA makes the final attainment and nonattainment determinations. States must come up with a state implementation plan (SIP) to get nonattainment areas into attainment and maintain air quality in attainment areas. A company with facilities located in a nonattainment area will be most affected. Their facilities may be subject to additional data submissions and measurement during permitting renewals, their facilities may need to meet new emission limitations set by the SIP (which could result in significant capital expenditures), and the company may have additional expenses and/or difficulties expanding existing facilities or building new facilities. The process from determining acceptable primary and/or secondary NAAQS to executing SIPs can take years. Nonetheless, because the NAAQS regulations have the potential to affect both existing and new facilities in areas, MGE continuously monitors changes to these rules to evaluate whether changes could impact our operations. In addition, the EPA has adopted interstate transport rules such as the CSAPR to address contributions to NAAQS nonattainment from upwind sources in neighboring states. In the following paragraphs we discuss specific NAAQS and transport rule developments that may affect MGE.

*Ozone NAAQS*

In October 2015, the EPA revised the primary and secondary ozone NAAQS, lowering each to 70 ppb. The rule became effective in December 2015. In November 2016, the EPA introduced a proposed implementation rule for the revised standard. Based on current ozone monitoring data, it appears that Milwaukee County (where our Elm Road Units are located) will likely not attain the lowered standards, and Dane and Columbia Counties (where our WCCF/Blount and Columbia Units are located, respectively) may attain them. Final attainment designations for these three counties will be based upon air monitoring data for years 2014-2016. The EPA will finalize the designations by October 1, 2017 based on that data. Once these EPA designations are complete, the State of Wisconsin will need to develop implementation plans for each county designated as nonattainment, which could affect operations and emission control obligations for plants located within the nonattainment counties.

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The State of Wisconsin has joined a lawsuit filed by several states challenging the EPA's new ozone standard, alleging that the new standard is not attainable and the EPA is not properly considering background levels in setting its ozone attainment levels. Oral arguments in this case are scheduled to begin in April 2017. MGE will continue to monitor the EPA's progress on attainment designations and related litigation to assess potential impacts at our facilities, particularly our Elm Road Units.

#### Sulfur Dioxide (SO<sub>2</sub>) NAAQS

In March 2015, the EPA identified MGE's Columbia Plant in Columbia County as a large stationary source of SO<sub>2</sub> that may exceed the one hour SO<sub>2</sub> NAAQS standard and was subject to a State of Wisconsin proposed county attainment/nonattainment determination. In September 2015, Wisconsin sent a letter to the EPA proposing that Columbia County be designated as being in attainment for the SO<sub>2</sub> NAAQS based on recent modeling demonstrating that SO<sub>2</sub> pollution controls on the Columbia Plant had brought the county into attainment. In June 2016, the EPA issued a final rule classifying Columbia County as an unclassified/attainment area. MGE does not anticipate any material costs from this rule.

#### Nitrogen Dioxide (NO<sub>2</sub>) NAAQS

The WDNR has revised its state rules to incorporate the EPA's one hour NO<sub>2</sub> NAAQS rule that was finalized in 2010. The effective date of the state rule was August 1, 2016. The WDNR is currently seeking input from the public on ideas for implementing this one-hour standard. Wisconsin's NO<sub>2</sub> NAAQS rule will affect our stationary fossil-fuel generation sources by requiring that we demonstrate consistency with the NAAQS when applying for certain air permits. Sources that cannot demonstrate compliance with the NAAQS may be required to install emission controls or restrict operations. MGE will continue to monitor developments while the WDNR implements guidance for compliance with the one-hour NAAQS.

#### EPA's Cross-State Air Pollution Rule: Proposed Ozone Season Update based on 2008 Ozone NAAQS

The EPA's Cross-State Air Pollution Rule (CSAPR) is an interstate air pollution transport rule designed to reduce ozone and fine particulate (PM<sub>2.5</sub>) air levels in areas that the EPA has determined are being affected by pollution from neighboring and upwind states. This is accomplished in the CSAPR through a reduction in SO<sub>2</sub> and NO<sub>x</sub> from qualifying fossil-fuel fired power plants in upwind or "contributing" states. NO<sub>x</sub> and SO<sub>2</sub> contribute to fine particulate pollution, and NO<sub>x</sub> contributes to ozone formation. Reductions are achieved through a cap and trade system. Individual plants can meet their caps through modifications and/or buying allowances on the market.

In October 2016, the EPA finalized rulemaking for an update to CSAPR that incorporated 2008 Ozone NAAQS levels into the rule (the original CSAPR is based on 1997 Ozone NAAQS levels). The update affects 22 states, including Wisconsin, by further limiting statewide NO<sub>x</sub> allowances in each of those states. The rule also includes revisions to CSAPR that are designed to address issues remaining from the D.C. Circuit remand of CSAPR, including Wisconsin's inclusion in the NO<sub>x</sub> ozone season portion of the rule. The State of Wisconsin filed a legal challenge to the CSAPR update rule asserting, among other things, that the rule over-controls NO<sub>x</sub> emissions in Wisconsin.

The CSAPR Update rule will further reduce summertime (or Ozone Season) NO<sub>x</sub> emissions allocations from power plants starting in 2017. MGE intends to meet the rule requirements through a combination of owned, received, and purchased. Depending on the number of allocations MGE receives for ozone season, the number of allocations that MGE must purchase, and the cost of allocations, this requirement could be material for MGE.

#### Clean Air Visibility Rule (CAVR)

Columbia is subject to the best available retrofit technology (BART) regulations, a subsection of the EPA's Clean Air Visibility Rule (CAVR), which may require pollution control retrofits. Columbia's existing pollution control upgrades, and the EPA's stance that compliance with the CSAPR equals compliance with BART, should mean that Columbia will not need to do additional work to meet BART requirements. At this time, however, the BART regulatory obligations, compliance strategies, and costs remain uncertain due to the continued legal challenges surrounding CSAPR and CAVR.

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In December 2016, the EPA introduced a final rule (posted online but not yet scheduled for publication in the Federal Register) extending state implementation plan deadlines by three years from 2018 to 2021 for the next implementation phase of the CAVR, which goes beyond BART and may affect utilities. This extension would allow for states to coordinate their CAVR compliance with other compliance efforts, which should lessen the burden to comply. It is too early to determine if the rule will affect MGE. MGE will continue to monitor developments.

## **Solid Waste**

### *EPA's Coal Combustion Residuals Rule*

In December 2014, the EPA finalized its Disposal of Coal Combustion Residuals from Electric Utilities (CCR) rule. The rule became effective in October 2015. It provides that coal ash will be regulated as a solid waste, and defines what ash use activities would be considered generally exempt beneficial reuse of coal ash. The rule also regulates landfills, ash ponds, and other surface impoundments for coal combustion residuals by regulating their design, location, monitoring, and operation. This portion of the rule is accomplished in phases to allow for sites with onsite storage and/or disposal to evaluate their compliance with the rule's design criteria. Landfills and impoundments that cannot meet design criteria will need to close formally within defined timeframes.

The Columbia and Elm Road Units co-owners and plant operators are working through the phased requirements to plan and implement changes necessary at those facilities to meet design criteria. Review of our Elm Road Units has indicated that the costs to comply with this rule are not expected to be significant. Columbia's operator has developed a preliminary implementation schedule for meeting the various deadlines spelled out in the rule. Costs at Columbia will be dependent on what is determined during the evaluation stage. Management believes compliance costs will be recovered in future rates based on previous treatment of environmental compliance projects.

## **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 as noted below.

### *Columbia Clean Air Act Litigation*

Columbia is a coal-fired generating station operated by WPL in which WPL, WPSC, and MGE have ownership interests. In December 2009, the EPA sent a Notice of Violation (NOV) to the co-owners, including MGE. The NOV alleged that WPL, which is the plant operator, and the Columbia co-owners failed to comply with appropriate pre-construction review and permitting requirements and, as a result, violated the Prevention of Significant Deterioration program requirements, Title V Operating Permit requirements of the CAA, and the Wisconsin SIP. In June 2013, the court approved and entered a consent decree entered by the EPA, Sierra Club, and the co-owners of Columbia. One of the requirements of the consent decree requires installation of an SCR system at Columbia Unit 2 by December 31, 2018. Installation of the SCR has been approved by the PSCW and is currently under construction. MGE's share of the projected cost for the SCR system is estimated to be \$22-\$24 million, with expected completion in 2018.

#### **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. 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. MGE does not expect the resolution of these matters to have a material adverse effect on its consolidated results of operations, financial condition, or cash flows.

#### **e. Other Commitments.**

MGE Energy holds investments in nonpublic entities. From time to time, these entities require additional capital infusions from their investors. MGE Energy has committed to contribute \$11.4 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.

In addition, MGE Energy has a three year agreement with a venture debt fund expiring in December 2019. MGE Energy has committed to invest up to a total of \$1.5 million into this fund. As of December 31, 2016, MGE Energy has \$0.4 million remaining in commitments. The timing of infusions is dependent on the needs of the fund and is therefore uncertain at this time.

MGE has several other commitments related to various projects. Payments for these commitments are expected to be as follows:

<i>(In thousands)</i>	2017	2018	2019	2020	2021	Thereafter
Other commitments.....	\$ 1,317	\$ 1,175	\$ 511	\$ 497	\$ 440	\$ 5,646

## 18. Asset Retirement Obligations - MGE Energy and MGE.

MGE recorded an obligation for the fair value of its legal liability for asset retirement obligations (AROs) associated with removal of the West Campus Cogeneration Facility and the Elm Road Units, electric substations, combustion turbine generating units, wind generating facilities, and photovoltaic generating facilities, all of which are located on property not owned by MGE Energy and MGE and would need to be removed upon the ultimate end of the associated leases. The significant conditional AROs identified by MGE included the costs of abandoning in place gas services and mains, the abatement and disposal of equipment and buildings contaminated with asbestos and PCBs, and the proper disposal and removal of tanks, batteries, and underground cable. Changes in management's assumptions regarding settlement dates, settlement methods, or assigned probabilities could have a material effect on the liabilities recorded by MGE at December 31, 2016, as well as the regulatory asset recorded.

MGE also may have AROs relating to the removal of various assets, such as certain electric and gas distribution facilities. These facilities are generally located on property owned by third parties, on which MGE is permitted to operate by lease, permit, easement, license, or service agreement. The asset retirement obligations associated with these facilities cannot be reasonably determined due to the indeterminate life of the related agreements.

The following table summarizes the change in AROs. Amounts include conditional AROs.

<i>(In thousands)</i>	2016	2015
Balance at January 1, .....	\$ 24,360	\$ 19,744
Liabilities incurred <sup>(a)</sup> .....	1,303	2,380
Accretion expense .....	1,269	1,131
Liabilities settled .....	(110)	(124)
Revisions in estimated cash flows <sup>(a)</sup> .....	64	1,229
Balance at December 31, .....	<u>\$ 26,886</u>	<u>\$ 24,360</u>

- (a) In the second quarter of 2015, MGE recorded an obligation of \$2.3 million for the fair value of its legal liability for AROs associated with the effect of the final Coal Combustion Residual Rule at Columbia. An additional \$1.3 million was recorded in the fourth quarter, associated with this ARO, based on revised estimates.

## 19. Adoption of Accounting Principles and Recently Issued Accounting Pronouncements - MGE Energy and MGE.

### a. Revenue from Contracts with Customers.

In May 2014, the FASB issued authoritative guidance within the Codification's Revenue Recognition topic that provides guidance on the recognition, measurement, and disclosure of revenue from contracts with customers. The new standard establishes a five step model for recognizing and measuring revenue from contracts with customers and replaces existing guidance on revenue recognition. The objective of the new standard is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within industries, across industries and across capital markets. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services.

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MGE Energy and MGE have been assessing the impact of this guidance on revenue streams within the scope of the new standard. All retail electric and gas revenues are tariff rates approved by the PSCW. Based on our evaluation of the new standard, retail revenues will be recognized within the period in which utility service is provided to the customer and the performance obligation is fulfilled, consistent with our current revenue recognition model. Electric revenues for sales to the market represent wholesale sales made to third parties who are not ultimate users of the electricity. These sales may also include bilateral sales to other utilities or power marketers. Revenues for sales to the market will be recognized when the sale is completed within the market operated by MISO, similar to the recognition under our current revenue recognition model. In addition, revenues from the transportation of gas will continue to be recognized upon the performance of services for the respective customer. Based on our assessment of the new standard, revenue recognition for retail revenues, sales to the market, and transportation of gas will be consistent with our current revenue recognition model. However, additional disclosures regarding the nature, amount, timing, and uncertainty of these revenue streams and related cash flows arising from contracts with customers will be required as a result of the new standard.

The Power and Utilities Task Force of the AICPA is formulating a utility industry-specific interpretation of the guidance regarding the collectability threshold of probable within the new standard. The collectability criterion could impact the timing of revenue recognition for uncollectible accounts. The Power and Utilities Task Force of the AICPA is also requesting the FASB issue an industry-specific clarification regarding the accounting treatment of upfront contributions in the aid of construction, also known as CIAC. The final clarification on this topic could result in a material impact on the consolidated financial statements. Management continues to analyze newly-released interpretative guidance and assess the related impacts to the current revenue recognition model.

This authoritative guidance will become effective January 1, 2018, and MGE Energy and MGE anticipate adopting the standard upon the effective date. Adoption of this standard is permitted under one of two methods: the full retrospective method or the modified retrospective method. MGE Energy and MGE are continuing to assess the permitted implementation methods and the impact on our financial statements.

**b. Consolidation.**

In February 2015, the FASB issued authoritative guidance within the Codification's Consolidation topic that provides guidance on the evaluation of certain legal entities for consolidation purposes. This authoritative guidance became effective January 1, 2016. This guidance had no impact on our financial statements.

**c. Debt Issuance Costs.**

In April 2015, the FASB issued authoritative guidance within the Codification's Interest topic that provides guidance on the presentation of debt issuance costs in financial statements. This authoritative guidance became effective January 1, 2016, and changed the presentation of debt issuance costs on the balance sheet. Prior to the authoritative guidance, debt issuance costs were treated as a deferred asset, and beginning January 1, 2016, these costs are included as a direct deduction to the related debt liability on the consolidated balance sheets. As of December 31, 2016, assets (other deferred assets and other) and liabilities (long-term debt) decreased approximately \$3.9 million as a cumulative result of the guidance. In addition, this guidance was applied retrospectively to all prior periods presented, resulting in a decrease to assets and liabilities of \$4.3 million for the year ended December 31, 2015.

**d. Financial Instruments.**

In January 2016, the FASB issued authoritative guidance within the Codification's Financial Instruments topic that provides guidance on the recognition and measurement of financial instruments. This authoritative guidance will become effective January 1, 2018, and will require equity investments to be measured at fair value with changes in fair value recognized in net income rather than in other comprehensive income. As a result of this guidance, MGE Energy and MGE will no longer have any other comprehensive income. This standard will be applied using a modified retrospective approach, with a cumulative effect adjustment recorded to opening retained earnings as of the beginning of all prior periods presented.

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**e. Leases.**

In February 2016, the FASB issued authoritative guidance within the Codification's Leases topic that provides guidance on the classification, recognition, measurement, and disclosure of leases. The new leasing standard establishes that a lease conveys the right to control the use of identified property, plant, or equipment for a period of time in exchange for consideration. Under the new guidance, lessees will be required to recognize all leases with terms greater than one year, including operating leases, on the consolidated balance sheet by recording a right-of-use asset and lease liability. Prior to the authoritative guidance, only capital leases were recognized on the balance sheet by lessees. The new accounting guidance as applied by lessors is materially consistent from that applied under current GAAP.

Management has begun utilizing a bottoms-up approach to analyze the impact of the standard on our lease portfolio. MGE Energy and MGE have been reviewing current accounting policies and procedures to identify potential differences in accounting treatment that would result from applying the requirements of the new standard to our existing lease portfolio. In addition, we are identifying appropriate changes to our business processes, systems, and controls to support recognition and disclosure requirements under the new standard. This authoritative guidance will become effective January 1, 2019, with early adoption permitted. The new leasing standard requires entities to recognize and measure leases at the beginning of the earliest comparative period presented using a modified retrospective approach. MGE Energy and MGE are currently assessing the impact this pronouncement will have on our financial statements.

**f. Restricted Cash.**

In November 2016, the FASB issued authoritative guidance within the Codification's Statement of Cash Flows topic that provides guidance on the classification and presentation of changes in restricted cash within the statement of cash flows. The new standard was issued to eliminate a current diversity in practice for the accounting treatment of restricted cash. Under the new guidance, reporting entities will be required to explain the changes in the total of restricted and unrestricted cash and cash equivalents when reconciling the beginning and ending balances on the statement of cash flows. Prior to the authoritative guidance, changes in restricted cash were presented as either cash flows from operating, investing, or financing activities within the statement of cash flows, as appropriate based on the nature of the restriction. Also under the new standard, reporting entities will be required to provide a reconciliation from the balance sheet to the statement of cash flows and disclose the nature of the restrictions of cash. This authoritative guidance will become effective January 1, 2018. Upon the effective date, MGE Energy and MGE will change the presentation of restricted cash to reflect this change in accounting guidance. MGE Energy and MGE will also retrospectively apply the guidance to all prior periods presented. As of December 31, 2016, MGE Energy and MGE had \$5.1 million of restricted cash classified within other current assets on the consolidated balance sheets.

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

The electric utility business purchases, generates and distributes electricity, and contracts for transmission service. The gas utility business purchases and distributes natural gas and contracts for the transportation of natural gas. Both the electric and gas segments operate through MGE Energy's principal subsidiary, MGE.

The nonregulated energy operations are conducted through MGE Energy's subsidiaries: MGE Power, MGE Power Elm Road, and MGE Power West Campus. These subsidiaries own and lease electric generating capacity to assist MGE. MGE Power Elm Road has an ownership interest in two coal-fired generating units in Oak Creek, Wisconsin, which are leased to MGE, and MGE Power West Campus owns a controlling interest in the electric generation plant of a natural gas-fired cogeneration facility on the UW campus. MGE Power West Campus's portion is also leased to MGE.

The transmission investment segment invests, through MGE Transco, in ATC, a company that provides electric transmission services primarily in Wisconsin and MGEE Transco, in ATC Holdco, a company formed to pursue electric transmission development and investments outside of Wisconsin. See Footnote 4 for further discussion.

The "All Others" segment includes: corporate, CWDC, MAGAEL, MGE State Energy Services, MGE Services, and NGV Fueling Services. These entities' operations consist of investing in companies and property which relate to the regulated operations, financing the regulated operations, or owning and operating natural gas compression equipment.

General corporate expenses include the cost of executive management, corporate accounting and finance, information technology, risk management, human resources and legal functions, and employee benefits that are allocated to electric and gas segments based on formulas prescribed by the PSCW. Identifiable assets are those used in MGE's operations in each segment. Assets not allocated consist primarily of cash and cash equivalents, restricted cash, investments, other accounts receivable, and prepaid assets.

Sales between our electric and gas segments are based on PSCW approved tariffed rates. Additionally, intersegment operations related to the leasing arrangement between our electric segment and MGE Power Elm Road/MGE Power West Campus are based on terms previously approved by the PSCW. Consistent with internal reporting, management has presented the direct financing capital leases between MGE and MGE Power Elm Road/MGE Power West Campus based on actual lease payments included in rates. Lease payments made by MGE to MGE Power Elm Road and MGE Power West Campus are shown as operating expenses. The lease payments received by MGE Power Elm Road and MGE Power West Campus from MGE are shown as lease income in interdepartmental revenues. The depreciation expense associated with the Elm Road Units and WCCF is reflected in the nonregulated energy segment.

The following table shows segment information for MGE Energy's and MGE's operations:

(In thousands)  
MGE Energy

	Electric	Gas	Non-Regulated Energy	Transmission Investment	All Others	Consolidation/ Elimination Entries	Consolidated Total
<b>Year Ended December 31, 2016</b>							
Operating revenues .....	\$ 409,006	\$ 134,543	\$ 1,196	\$ -	\$ -	\$ -	\$ 544,745
Interdepartmental revenues.....	1,912	21,378	43,930	-	-	(67,220)	-
Total operating revenues .....	410,918	155,921	45,126	-	-	(67,220)	544,745
Depreciation and amortization .....	(29,122)	(8,128)	(7,372)	-	(24)	-	(44,646)
Other operating expenses.....	(310,941)	(127,083)	(155)	(17)	(895)	67,220	(371,871)
Operating income (loss) .....	70,855	20,710	37,599	(17)	(919)	-	128,228
Other income, net .....	960	30	-	8,429	292	-	9,711
Interest (expense) income, net .....	(11,147)	(3,223)	(5,768)	-	272	-	(19,866)
Income (loss) before taxes.....	60,668	17,517	31,831	8,412	(355)	-	118,073
Income tax (provision) benefit .....	(20,115)	(6,894)	(12,775)	(2,836)	107	-	(42,513)
Net income (loss) .....	\$ 40,553	\$ 10,623	\$ 19,056	\$ 5,576	\$ (248)	\$ -	\$ 75,560
<b>Year Ended December 31, 2015</b>							
Operating revenues .....	\$ 412,528	\$ 143,737	\$ 7,763	\$ -	\$ -	\$ -	\$ 564,028
Interdepartmental revenues.....	513	11,780	39,435	-	-	(51,728)	-
Total operating revenues .....	413,041	155,517	47,198	-	-	(51,728)	564,028
Depreciation and amortization .....	(29,945)	(6,758)	(7,475)	-	(47)	-	(44,225)
Other operating expenses.....	(318,001)	(128,241)	(158)	(19)	(857)	51,728	(395,548)
Operating income (loss) .....	65,095	20,518	39,565	(19)	(904)	-	124,255
Other (deductions) income, net .....	400	(33)	-	7,728	518	-	8,613
Interest (expense) income, net .....	(11,187)	(3,203)	(5,993)	-	221	-	(20,162)
Income (loss) before taxes.....	54,308	17,282	33,572	7,709	(165)	-	112,706
Income tax (provision) benefit .....	(17,915)	(6,915)	(13,474)	(3,102)	43	-	(41,363)
Net income (loss) .....	\$ 36,393	\$ 10,367	\$ 20,098	\$ 4,607	\$ (122)	\$ -	\$ 71,343
<b>Year Ended December 31, 2014</b>							
Operating revenues .....	\$ 394,849	\$ 221,720	\$ 3,283	\$ -	\$ -	\$ -	\$ 619,852
Interdepartmental revenues.....	509	8,366	42,692	-	-	(51,567)	-
Total operating revenues .....	395,358	230,086	45,975	-	-	(51,567)	619,852
Depreciation and amortization .....	(26,933)	(6,308)	(7,407)	-	(47)	-	(40,695)
Other operating expenses.....	(297,409)	(194,203)	(139)	-	(875)	51,567	(441,059)
Operating income (loss) .....	71,016	29,575	38,429	-	(922)	-	138,098
Other (deductions) income, net .....	2,847	(86)	-	9,150	(1,832)	-	10,079
Interest (expense) income, net .....	(10,410)	(3,229)	(6,208)	-	174	-	(19,673)
Income (loss) before taxes.....	63,453	26,260	32,221	9,150	(2,580)	-	128,504
Income tax (provision) benefit .....	(22,070)	(10,480)	(12,932)	(3,664)	961	-	(48,185)
Net income (loss) .....	\$ 41,383	\$ 15,780	\$ 19,289	\$ 5,486	\$ (1,619)	\$ -	\$ 80,319

(In thousands)

**MGE**

	Electric	Gas	Non-Regulated Energy	Transmission Investment <sup>(b)</sup>	Consolidation/ Elimination Entries	Consolidated Total
<b>Year Ended December 31, 2016</b>						
Operating revenues .....	\$ 409,030	\$ 134,572	\$ 1,196	\$ -	\$ -	\$ 544,798
Interdepartmental revenues.....	1,888	21,349	43,930	-	(67,167)	-
Total operating revenues .....	410,918	155,921	45,126	-	(67,167)	544,798
Depreciation and amortization .....	(29,122)	(8,128)	(7,372)	-	-	(44,622)
Other operating expenses <sup>(a)</sup> .....	(330,924)	(133,940)	(12,930)	-	67,167	(410,627)
Operating income <sup>(a)</sup> .....	50,872	13,853	24,824	-	-	89,549
Other (deductions) income, net <sup>(a)</sup> .....	828	(7)	-	4,360	-	5,181
Interest expense, net .....	(11,147)	(3,223)	(5,768)	-	-	(20,138)
Net income .....	40,553	10,623	19,056	4,360	-	74,592
Less: Net income attributable to noncontrolling interest, net of tax .....	-	-	-	-	(23,358)	(23,358)
Net income attributable to MGE .....	\$ 40,553	\$ 10,623	\$ 19,056	\$ 4,360	\$ (23,358)	\$ 51,234

**Year Ended December 31, 2015**

Operating revenues .....	\$ 412,550	\$ 143,752	\$ 7,763	\$ -	\$ -	\$ 564,065
Interdepartmental revenues.....	491	11,765	39,435	-	(51,691)	-
Total operating revenues .....	413,041	155,517	47,198	-	(51,691)	564,065
Depreciation and amortization .....	(29,945)	(6,758)	(7,475)	-	-	(44,178)
Other operating expenses <sup>(a)</sup> .....	(335,803)	(135,124)	(13,632)	(19)	51,691	(432,887)
Operating income (loss) <sup>(a)</sup> .....	47,293	13,635	26,091	(19)	-	87,000
Other (deductions) income, net <sup>(a)</sup> .....	287	(65)	-	4,626	-	4,848
Interest expense, net .....	(11,187)	(3,203)	(5,993)	-	-	(20,383)
Net income .....	36,393	10,367	20,098	4,607	-	71,465
Less: net income attributable to noncontrolling interest, net of tax .....	-	-	-	-	(26,097)	(26,097)
Net income attributable to MGE .....	\$ 36,393	\$ 10,367	\$ 20,098	\$ 4,607	\$ (26,097)	\$ 45,368

**Year Ended December 31, 2014**

Operating revenues .....	\$ 394,871	\$ 221,741	\$ 3,283	\$ -	\$ -	\$ 619,895
Interdepartmental revenues.....	487	8,345	42,692	-	(51,524)	-
Total operating revenues .....	395,358	230,086	45,975	-	(51,524)	619,895
Depreciation and amortization .....	(26,933)	(6,308)	(7,407)	-	-	(40,648)
Other operating expenses <sup>(a)</sup> .....	(319,175)	(204,597)	(13,071)	-	51,524	(485,319)
Operating income <sup>(a)</sup> .....	49,250	19,181	25,497	-	-	93,928
Other (deductions) income, net <sup>(a)</sup> .....	2,543	(172)	-	5,486	-	7,857
Interest expense, net .....	(10,410)	(3,229)	(6,208)	-	-	(19,847)
Net income .....	41,383	15,780	19,289	5,486	-	81,938
Less: Net income attributable to noncontrolling interest, net of tax .....	-	-	-	-	(26,310)	(26,310)
Net income attributable to MGE .....	\$ 41,383	\$ 15,780	\$ 19,289	\$ 5,486	\$ (26,310)	\$ 55,628

(a) Amounts are shown net of the related tax expense, consistent with the presentation on the MGE Consolidated Statements of Income.

(b) As of July 31, 2016, MGE no longer consolidates MGE Energy's proportionate share of equity earnings in MGE Transco.

See Footnote 4 for additional information.

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

(In thousands) MGE Energy	Utility			Consolidated				Consolidation/ Elimination Entries	Total
	Electric	Gas	Assets not Allocated	Non-regulated Energy	Transmission Investment	All Others			
<i>Assets:</i>									
December 31, 2016 .....	\$ 1,021,905	\$ 318,603	\$ 27,338	\$ 271,277	\$ 74,535	\$ 465,202	\$ (377,800)	\$ 1,801,060	
December 31, 2015 <sup>(c)</sup> .....	974,235	298,435	49,753	277,858	69,470	434,868	(378,216)	1,726,403	
December 31, 2014 <sup>(c)</sup> .....	945,790	306,106	41,124	280,542	67,697	438,898	(390,636)	1,689,521	
<i>Capital Expenditures:</i>									
Year ended Dec. 31, 2016 ....	\$ 50,699	\$ 29,136	\$ -	\$ 3,824	\$ -	\$ -	\$ -	\$ 83,659	
Year ended Dec. 31, 2015 ....	49,370	18,787	-	3,873	-	-	-	72,030	
Year ended Dec. 31, 2014 ....	68,067	22,104	-	2,505	-	-	-	92,676	

(In thousands) MGE	Utility			Consolidated			Consolidation/ Elimination Entries	Total
	Electric	Gas	Assets not Allocated	Non-regulated Energy	Transmission Investment <sup>(d)</sup>			
<i>Assets:</i>								
December 31, 2016 .....	\$ 1,021,905	\$ 318,603	\$ 27,338	\$ 271,227	\$ -	\$ (221)	\$ 1,638,852	
December 31, 2015 <sup>(c)</sup> .....	974,235	298,435	49,753	277,808	69,470	(187)	1,669,514	
December 31, 2014 <sup>(c)</sup> .....	945,790	306,106	41,124	280,492	67,697	(6,521)	1,634,688	
<i>Capital Expenditures:</i>								
Year ended Dec. 31, 2016 ....	\$ 50,699	\$ 29,136	\$ -	\$ 3,824	\$ -	\$ -	\$ 83,659	
Year ended Dec. 31, 2015 ....	49,370	18,787	-	3,873	-	-	72,030	
Year ended Dec. 31, 2014 ....	68,067	22,104	-	2,505	-	-	92,676	

(c) Reflects retrospective application of new accounting pronouncement related to debt issuance costs, see Footnote 19 for additional information.

(d) In December 2016, MGE's ownership interest in MGE Transco was transferred to MGE Energy, see Footnote 4 for additional information.

## 21. Quarterly Summary of Operations - MGE Energy (unaudited).

(In thousands, except per share amounts) 2016	Quarters Ended			
	March 31	June 30	September 30	December 31
<i>Operating revenues:</i>				
Electric revenues .....	\$ 93,690	\$ 100,615	\$ 119,147	\$ 96,750
Gas revenues .....	53,837	20,961	17,570	42,175
Total Operating Revenues .....	147,527	121,576	136,717	138,925
Operating expenses .....	117,996	93,364	90,190	114,967
Operating income .....	29,531	28,212	46,527	23,958
Interest and other income, net .....	(2,558)	(2,778)	(2,933)	(1,886)
Income tax provision .....	(9,945)	(9,284)	(15,714)	(7,570)
Earnings on common stock .....	\$ 17,028	\$ 16,150	\$ 27,880	\$ 14,502
Earnings per common share .....	\$ 0.49	\$ 0.47	\$ 0.80	\$ 0.42
Dividends per share .....	\$ 0.295	\$ 0.295	\$ 0.308	\$ 0.308
<b>2015</b>				
<i>Operating revenues:</i>				
Electric revenues .....	\$ 100,206	\$ 101,457	\$ 123,364	\$ 95,264
Gas revenues .....	69,928	20,669	17,431	35,709
Total Operating Revenues .....	170,134	122,126	140,795	130,973
Operating expenses .....	138,283	98,077	94,618	108,795
Operating income .....	31,851	24,049	46,177	22,178
Interest and other income, net .....	(2,986)	(2,562)	(2,472)	(3,529)
Income tax provision .....	(10,587)	(8,008)	(15,351)	(7,417)
Earnings on common stock .....	\$ 18,278	\$ 13,479	\$ 28,354	\$ 11,232
Earnings per common share .....	\$ 0.53	\$ 0.39	\$ 0.82	\$ 0.32
Dividends per share .....	\$ 0.283	\$ 0.283	\$ 0.295	\$ 0.295

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**Notes:**

- The quarterly results of operations within a year may not be comparable because of seasonal and other factors.
- The sum of earnings per share of common stock for any four quarters may vary slightly from the earnings per share of common stock for the equivalent twelve-month period due to rounding.
- MGE Energy's operations are based primarily on its utility subsidiary MGE.

**22. Related Party Transactions - MGE Energy and MGE.**

*ATC*

During 2016, 2015, and 2014, MGE recorded \$29.1 million, \$28.2 million, and \$26.8 million, respectively, for transmission services received from ATC. MGE also provides a variety of operational, maintenance, and project management work for ATC, which is reimbursed by ATC. For the years ended December 31, 2016 and 2014, MGE had a receivable due from ATC of \$0.1 million. For the year ended December 31, 2015, MGE had a receivable due from ATC of \$0.2 million.

For additional discussion on MGE's relationship with ATC, see Footnote 4.

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**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.****MGE Energy and MGE**

None.

**Item 9A. Controls and Procedures.****MGE Energy and MGE***Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

During the fourth quarter of 2016, 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 its principal executive officer and its principal financial officer, 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 December 31, 2016, the principal executive officer and principal financial officer of each registrant concluded that such registrant's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective to accomplish their objectives. 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 December 31, 2016, there were no changes in MGE Energy or MGE's internal controls over financial reporting that materially affected, or are reasonably likely to affect materially, MGE Energy or MGE's internal control over financial reporting.

**MGE Energy and MGE**

Management of MGE Energy and MGE are required to assess and report on the effectiveness of its internal control over financial reporting as of December 31, 2016. As a result of that assessment, management determined that there were no material weaknesses as of December 31, 2016 and, therefore, concluded that MGE Energy and MGE's internal control over financial reporting was effective. Management's Report on Internal Control Over Financial Reporting is included in Item 8. Financial Statements and Supplementary Data.

**Item 9B. Other Information.****MGE Energy**

None.

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## **PART III.**

### **Item 10. Directors, Executive Officers, and Corporate Governance.**

#### **MGE Energy**

The information required by Item 10 relating to directors and nominees for election as directors at MGE Energy's annual meeting of shareholders is incorporated herein by reference to the information under the heading "ELECTION OF DIRECTORS" in MGE Energy's definitive proxy statement (2017 Proxy Statement) to be filed with the SEC on or before March 27, 2017. Information relating to compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated herein by reference to the information under the heading "BENEFICIAL OWNERSHIP - Section 16(a) Beneficial Ownership Reporting Compliance" in the 2017 Proxy Statement.

The information required by Item 10 relating to executive officers is set forth above in Item 1. Business - Executive Officers of the Registrants.

#### **Code of Ethics**

MGE Energy has adopted a Code of Ethics applicable to its directors and all of its employees, including its chief executive officer, chief financial officer, and principal accounting officer. The Code of Ethics is available on MGE Energy's website at [www.mgeenergy.com](http://www.mgeenergy.com).

### **Item 11. Executive Compensation.**

See Item 12.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

#### **MGE Energy**

The required information is included in the 2017 Proxy Statement, which will be filed with the SEC on or before March 27, 2017, for Item 11 under the section "EXECUTIVE COMPENSATION," not including "Compensation Committee Report," and "Cumulative Five-Year Total Return Comparison Graph," and for Item 12 under the section "BENEFICIAL OWNERSHIP," which is incorporated herein by reference.

MGE Energy does not have or maintain any compensation plans pursuant to which equity is issued.

### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

#### **MGE Energy**

The information required by Item 13 is incorporated by reference herein from the "BOARD OF DIRECTORS INFORMATION" section in the 2017 Proxy Statement, which will be filed with the SEC on or before March 27, 2017.

### **Item 14. Principal Accounting Fees and Services.**

#### **MGE Energy**

The information required by Item 14 is incorporated herein by reference to the information under the heading "RATIFICATION OF PRICEWATERHOUSECOOPERS LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM" in the 2017 Proxy Statement, which will be filed with the SEC on or before March 27, 2017.

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**MGE**

## Independent Registered Public Accounting Firm Fees Disclosure

	2016	2015
Audit fees <sup>(a)</sup> .....	\$ 823,495	\$ 822,605
Audit-related fees <sup>(b)</sup> .....	75,000	75,000
Tax fees <sup>(c)</sup> .....	83,027	137,965
All other fees <sup>(d)</sup> .....	236,509	7,900

- (a) Professional services rendered for the audits of the financial statements, review of the interim financial statements, opinion on the effectiveness of our internal control over financial reporting for MGE Energy, and services that generally only the independent auditor can reasonably provide, such as comfort letters, statutory audits, consents and assistance with and review of documents filed with the SEC.
- (b) Professional services rendered in connection with utility commission-mandated obligations.
- (c) Review of federal and state income tax returns and tax planning.
- (d) Other fees for 2016 include customer information system advisory services and a cyber-security risk assessment.

MGE is a wholly owned subsidiary of MGE Energy and does not have a separate audit committee. Instead, that function is fulfilled for MGE by the MGE Energy Audit Committee. The Audit Committee approves each engagement of the independent registered public accounting firm to render any audit or nonaudit services before the firm is engaged to render those services. The Chair of the Audit Committee or other designated Audit Committee member may represent the entire Audit Committee for purposes of this approval. Any services approved by the Chair or other designated Audit Committee members are reported to the full Audit Committee at the next scheduled Audit Committee meeting. No de minimis exceptions to this approval process are allowed under the Audit Committee Charter; and thus, none of the services described in the preceding table were approved pursuant to Rule 2-01(c)(7)(i)(C) of Regulation S-X.

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## PART IV.

### Item 15. Exhibits and Financial Statement Schedules.

#### (a) 1. Financial Statements.

<b>MGE Energy</b>	
Consolidated Statements of Income for the years ended December 31, 2016, 2015, and 2014 .....	54
Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015, and 2014 .....	54
Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015, and 2014.....	55
Consolidated Balance Sheets as of December 31, 2016 and 2015 .....	56
Consolidated Statements of Common Equity as of December 31, 2016, 2015, and 2014.....	57
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<b>MGE</b>	
Consolidated Statements of Income for the years ended December 31, 2016, 2015, and 2014 .....	58
Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015, and 2014 .....	58
Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015, and 2014.....	59
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#### 2. Financial Statement Schedule.

Schedule I – Condensed Parent Company Financial Statements.

Schedule II – Valuation and Qualifying Accounts for MGE Energy, Inc. and Madison Gas and Electric Company.

All other schedules have been omitted because they are not applicable or not required, or because the required information is shown in the consolidated financial statements or notes thereto.

#### 3. All Exhibits Including Those Incorporated by Reference.

Exhibits. Several of the following exhibits are incorporated herein by reference under Rule 12b-32 of the Securities Exchange Act of 1934, as amended, as indicated by the parenthetical reference. Several other instruments, which would otherwise be required to be listed below, have not been so listed because those instruments do not authorize securities in an amount that exceeds 10% of the total assets of the applicable registrant and its subsidiaries on a consolidated basis. The relevant registrant agrees to furnish a copy of any instrument that was so omitted on that basis to the Commission upon request.

- 3.1 Amended and Restated Articles of Incorporation of MGE Energy, Inc. (Exhibit 4.1 to MGE Energy's Registration Statement on Form S-3, Registration No. 333-197423.)
- 3.2 Amended and Restated Bylaws of MGE Energy, Inc. (Exhibit 3.2 to MGE Energy's Registration Statement on Form S-4, Registration No. 333-72694.)
- 3.3 Restated Articles of Incorporation of Madison Gas and Electric Company as in effect at October 25, 2012. (Exhibit 3.1 to Form 8-K dated October 25, 2012, File No. 0-1125.)
- 3.4 Amended Bylaws of Madison Gas and Electric Company as in effect at August 16, 2002. (Exhibit 3.4 to Form 10-K for year ended December 31, 2002, File No. 0-1125.)
- 4.1 Indenture of Mortgage and Deed of Trust between Madison Gas and Electric Company and U.S. Bank, N.A. (successor to First Wisconsin Trust Company), as Trustee, dated as of January 1, 1946. (Exhibit 7-D to Registration Statement, Registration No. 2-6059.)

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- 4.2 Supplemental Indenture dated as of February 1, 1993 to aforementioned Indenture of Mortgage and Deed of Trust. (Exhibit 4F to Form 10-K for year ended December 31, 1992, File No. 0-1125.)
- 4.3 Indenture between Madison Gas and Electric Company and The Bank of New York Mellon Trust Company, N.A. (as successor to Bank One, N.A.), as Trustee, dated as of September 1, 1998. (Exhibit 4B to Form 10-K for year ended December 31, 1999, File No. 0-1125.)
- 10.1 Credit Agreement dated as of June 1, 2015, among MGE Energy, Inc., the Lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent. (Exhibit 10.1 to Form 8-K dated June 3, 2015, File No. 0-49965)
- 10.2 Credit Agreement dated as of June 1, 2015, among Madison Gas and Electric Company, the Lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent. (Exhibit 10.2 to Form 8-K dated June 3, 2015, File No. 0-1125.)
- 10.3 Credit Agreement dated as of June 1, 2015, among Madison Gas and Electric Company, the Lenders party thereto and U.S. Bank National Association, as Administrative Agent. (Exhibit 10.3 to Form 8-K dated June 3, 2015, File No. 0-1125.)
- 10.4 Copy of Joint Power Supply Agreement with Wisconsin Power and Light Company and Wisconsin Public Service Corporation dated February 2, 1967. (Exhibit 4.09 to Registration Statement, Registration No. 2-27308.)
- 10.5 Copy of Joint Power Supply Agreement (Exclusive of Exhibits) with Wisconsin Power and Light Company and Wisconsin Public Service Corporation dated July 26, 1973. (Exhibit 5.04A to Registration Statement, Registration No. 2-48781.)
- 10.6 Copy of Amended and Restated Agreement for Construction and Operation of Columbia Generating Plant dated January 17, 2007. (Exhibit 10.9 to Form 10-K for the year ended December 31, 2006, File No. 0-1125.)
- 10.7 West Campus Cogeneration Facility Joint Ownership Agreement, dated as of October 13, 2003, among MGE Power West Campus, LLC, The Board of Regents of the University of Wisconsin System, and the State of Wisconsin, as Joint Owners. (Exhibit 10.19 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
- 10.8 West Campus Cogeneration Facility Operation and Maintenance Agreement, dated as of October 13, 2003, among Madison Gas and Electric Company, as Operator, and the Board of Regents of the University of Wisconsin System, as Joint Owner. (Exhibit 10.20 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
- 10.9 West Campus Cogeneration Facility Lease Agreement, dated as of March 18, 2004, among MGE Power West Campus, LLC, as Lessor, and Madison Gas and Electric Company, as Lessee. (Exhibit 10.21 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
- 10.10 West Campus Cogeneration Facility Ground Lease, dated as of July 15, 2002, among MGE Power LLC, as Lessee, and the Board of Regents of the University of Wisconsin System, as Lessor. (Exhibit 10.22 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
- 10.11 West Campus Cogeneration Facility Amendment of Ground Lease, dated as of March 18, 2004, among MGE Power West Campus, LLC, as Lessee, and the Board of Regents of the University of Wisconsin System, as Lessor. (Exhibit 10.23 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
- 10.12 West Campus Cogeneration Facility MGE Ground Sublease, dated as of March 18, 2004, among MGE Power West Campus, LLC, as Lessee, and Madison Gas and Electric Company, as Lessor. (Exhibit 10.24 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)

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- 10.13 Elm Road Generating Station Common Facilities Operating and Maintenance Agreement, dated as of December 17, 2004, among Madison Gas and Electric Company, Wisconsin Electric Power Company, and Wisconsin Public Power Inc., as Lessee/Owner Parties, and Wisconsin Electric Power Company, as Operating Agent. (Exhibit 10.7 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.14 Elm Road Generating Station New Common Facilities Ownership Agreement, dated as of December 17, 2004, among MGE Power Elm Road, LLC, Elm Road Generating Station Supercritical, LLC, and Wisconsin Public Power Inc., as Joint Owners. (Exhibit 10.8 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.15 Elm Road Generating Station I Ownership Agreement, dated as of December 17, 2004, among MGE Power Elm Road, LLC, Elm Road Generating Station Supercritical, LLC, and Wisconsin Public Power Inc., as Joint Owners, Elm Road Services, LLC, as Project Manager, and W.E. Power LLC. (Exhibit 10.9 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.16 Elm Road Generating Station I Facility Lease Agreement, dated as of November 4, 2005, among MGE Power Elm Road, LLC, as Lessor, and Madison Gas and Electric Company, as Lessee. (Exhibit 10.10 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.17 Elm Road Generating Station I Operating and Maintenance Agreement, dated as of December 17, 2004, among Madison Gas and Electric Company, Wisconsin Electric Power Company, and Wisconsin Public Power Inc., as Lessee/ Owners, and Wisconsin Electric Power Company, as Operating Agent. (Exhibit 10.11 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.18 Elm Road Generating Station I Easement and Indemnification Agreement, dated as of December 17, 2004, among MGE Power Elm Road, LLC and Wisconsin Public Power Inc., as Grantees, and Wisconsin Electric Power Company, as Grantor. (Exhibit 10.12 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.19 Assignment and Assumption Agreement, dated as of November 4, 2005 between MGE Power Elm Road, LLC and Madison Gas and Electric Company relating to Elm Road Generating Station I Easement and Indemnification Agreement, dated as of December 17, 2004, among MGE Power Elm Road, LLC and Wisconsin Public Power Inc., as Grantees, and Wisconsin Electric Power Company, as Grantor. (Exhibit 10.16 to Form 10-K for the year ended December 31, 2005, File No. 0-1125.)
  - 10.20 Elm Road Generating Station II Ownership Agreement, dated as of December 17, 2004, among MGE Power Elm Road, LLC, Elm Road Generating Station Supercritical, LLC, and Wisconsin Public Power Inc., as Joint Owners, Elm Road Services, LLC, as Project Manager, and W.E. Power LLC. (Exhibit 10.13 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.21 Elm Road Generating Station II Facility Lease Agreement, dated as of November 4, 2005, among MGE Power Elm Road, LLC, as Lessor, and Madison Gas and Electric Company, as Lessee. (Exhibit 10.14 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.22 Elm Road Generating Station II Operating and Maintenance Agreement, dated as of December 17, 2004, among Madison Gas and Electric Company, Wisconsin Electric Power Company, and Wisconsin Public Power Inc., as Lessee/ Owners, and Wisconsin Electric Power Company, as Operating Agent. (Exhibit 10.15 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)
  - 10.23 Elm Road Generating Station II Easement and Indemnification Agreement, dated as of December 17, 2004, among MGE Power Elm Road, LLC and Wisconsin Public Power Inc., as Grantees, and Wisconsin Electric Power Company, as Grantor. (Exhibit 10.16 to Form 10-Q for the quarter ended September 30, 2005, File No. 0-1125.)

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- 10.24 Substation and Transformer Shared Use Agreement and Easement Agreement, dated as of September 29, 2006, among Madison Gas and Electric Company and Northern Iowa Windpower II LLC as Joint Owners. (Exhibit 10.6 to Form 10-Q for the quarter ended September 30, 2006, File No. 0-1125.)
- 10.25 Management and Administration Agreement, dated as of October 13, 2006, among Madison Gas and Electric Company as Owner and Midwest Renewable Energy Resources, LLC as Manager. (Exhibit 10.7 to Form 10-Q for the quarter ended September 30, 2006, File No. 0-1125.)
- 10.26\* Form of Severance Agreement. (Exhibit 10.37 to Form 10-K for the year ended December 31, 2008, File No. 0-49965.)
- 10.27\* Form of Amendment to Severance Agreement. (Exhibit 10.01 to Form 10-Q for the quarter ended March 31, 2016, File No. 0-49965.)
- 10.28\* Form of Severance Agreement for Officers hired on or after January 1, 2012. (Exhibit 10.2 to Form 10-Q for the quarter ended March 31, 2016, File No. 0-49965.)
- 10.29\* Form of Deferred Compensation Agreement. (Exhibit 10.38 to Form 10-K for the year ended December 31, 2008, File No. 0-49965.)
- 10.30\* Form of Amended and Restated Deferred Compensation Agreement. (Exhibit 10.39 to Form 10-K for the year ended December 31, 2008, File No. 0-49965.)
- 10.31\* Form of Income Continuation Agreement as revised January 1, 2016. (Exhibit 10.3 to Form 10-Q for the quarter ended March 31, 2016, File No. 0-49965.)
- 10.32\* Defined Contribution Supplemental Executive Retirement Plan
- 10.33\* Form of Participation Agreement for the Defined Contribution Supplemental Executive Retirement Plan
- 10.34\* MGE Energy, Inc., 2006 Performance Unit Plan. (Exhibit 10.41 to Form 10-K for the year ended December 31, 2008, File No. 0-49965.)
- 10.35\* Amendment Number One to MGE Energy, Inc., 2006 Performance Unit Plan, dated March 18, 2011. (Exhibit 10.2 to Form 8-K dated March 24, 2011, File No. 0-49965.)
- 10.36\* Amendment Number Two to MGE Energy, Inc., 2006 Performance Unit Plan, dated February 25, 2015. (Exhibit 10.1 to Form 8-K dated December 15, 2015, File No. 0-49965.)
- 10.37\* Form of Performance Unit Award Agreement. (Exhibit 10.42 to Form 10-K for the year ended December 31, 2008, File No. 0-49965.)
- 10.38\* Form of Amendment to Performance Unit Award Agreement. (Exhibit 10.1 to Form 8-K dated April 15, 2011, File No. 0-49965.)
- 10.39\* MGE Energy, Inc., 2013 Director Incentive Plan. (Exhibit 10.37 to Form 10-K for the year ended December 31, 2013, File No. 0-49965.)
- 10.40\* Form of 2013 Director Incentive Plan Award Agreement. (Exhibit 10.38 to Form 10-K for the year ended December 31, 2013, File No. 0-49965.)
- 12 Statements regarding computation of ratio of earnings to fixed charges:  
12.1 MGE Energy, Inc.  
12.2 Madison Gas and Electric Company
- 21 Subsidiaries of MGE Energy, Inc.
-

- 
- 23 Consent of Independent Registered Public Accounting Firm
- 23.1 MGE Energy, Inc.
- 23.2 Madison Gas and Electric Company
- 31 Certifications Pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 as to the Annual Report on Form 10-K for the year ended December 31, 2016, 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
- 32 Certifications Pursuant to Section 1350 of Chapter 63 of Title 18 United States Code (Sarbanes-Oxley Act of 2002) as to the Annual Report on Form 10-K for the year ended December 31, 2016, 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

\* Indicates a management contract or compensatory plan or arrangement.

## **Item 16. Form 10-K Summary.**

### **MGE Energy and MGE**

None.

**Schedule I**  
**Condensed Parent Company Financial Statements**

**MGE Energy, Inc.**  
**Statements of Comprehensive Income**  
*(Parent Company Only)*  
*(In thousands)*

	For the Years Ended December 31,		
	2016	2015	2014
<b>Operating Expenses:</b>			
Other operations and maintenance .....	\$ 720	\$ 690	\$ 689
<i>Total Operating Expenses</i> .....	<u>720</u>	<u>690</u>	<u>689</u>
<b>Operating Loss</b> .....	(720)	(690)	(689)
Equity in earnings of investments .....	75,581	71,306	81,811
Other income (loss), net .....	435	526	(1,879)
Other interest .....	176	136	93
Income before income taxes .....	75,472	71,278	79,336
Income tax provision.....	88	65	983
<b>Net Income</b> .....	<u>75,560</u>	<u>71,343</u>	<u>80,319</u>
<b>Other Comprehensive Income, Net of Tax:</b>			
Unrealized (loss) gain on available-for-sale securities, net of tax (\$104, \$67, and (\$54)).....	(155)	(101)	81
<b>Comprehensive Income</b> .....	<u>\$ 75,405</u>	<u>\$ 71,242</u>	<u>\$ 80,400</u>

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

**MGE Energy, Inc.**  
**Statements of Cash Flows**  
*(Parent Company Only)*  
*(In thousands)*

	For the Years Ended December 31,		
	2016	2015	2014
<b>Net Cash Flows Provided by Operating Activities</b> .....	\$ 74,994	\$ 37,085	\$ 48,165
<b>Investing Activities:</b>			
Other investing.....	(2,764)	(3,690)	(2,422)
<i>Cash Used for Investing Activities</i> .....	<u>(2,764)</u>	<u>(3,690)</u>	<u>(2,422)</u>
<b>Financing Activities:</b>			
Cash dividends paid on common stock .....	(41,775)	(40,043)	(38,429)
Other financing .....	(11)	-	(89)
<i>Cash Used for Financing Activities</i> .....	<u>(41,786)</u>	<u>(40,043)</u>	<u>(38,518)</u>
Change in cash and cash equivalents: .....	30,444	(6,648)	7,225
Cash and cash equivalents at beginning of period .....	51,781	58,429	51,204
<b>Cash and cash equivalents at end of period</b> .....	<u>\$ 82,225</u>	<u>\$ 51,781</u>	<u>\$ 58,429</u>

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

**Schedule I**  
**Condensed Parent Company Financial Statements (continued)**

**MGE Energy, Inc.**  
**Balance Sheets**  
*(Parent Company Only)*  
*(In thousands)*

	At December 31,	
	2016	2015
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents .....	\$ 82,225	\$ 51,781
Accounts receivable, net:		
Accounts receivable from affiliates .....	83	20
Other current assets .....	1,221	1,386
<i>Total Current Assets</i> .....	83,529	53,187
Other deferred assets and other .....	201	249
<b>Investments:</b>		
Investments in affiliates .....	684,968	649,276
Other investments .....	1,161	1,447
<i>Total Investments</i> .....	686,129	650,723
<b>Total Assets</b> .....	\$ 769,859	\$ 704,159
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable to affiliates .....	\$ 530	\$ 530
Accrued taxes .....	218	263
Other current liabilities .....	115	144
<i>Total Current Liabilities</i> .....	863	937
<b>Other Credits:</b>		
Deferred income taxes .....	40,672	7,998
Accounts payable to affiliates .....	4,236	4,766
<i>Total Other Credits</i> .....	44,908	12,764
<b>Shareholders' Equity:</b>		
Common shareholders' equity .....	350,936	350,936
Retained income .....	372,950	339,165
Other comprehensive income .....	202	357
<i>Total Shareholders' Equity</i> .....	724,088	690,458
Commitments and contingencies (see Footnote 3) .....	-	-
<b>Total Liabilities and Shareholders' Equity</b> .....	\$ 769,859	\$ 704,159

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

**Schedule I**  
**Condensed Parent Company Financial Statements (continued)**  
**Notes to Condensed Financial Statements**  
*(Parent Company Only)*

**1. Basis of Presentation.**

MGE Energy is a holding company and conducts substantially all of its business operations through its subsidiaries. For Parent Company only presentation, investment in subsidiaries are accounted for using the equity method. These condensed Parent Company financial statements and related notes have been prepared in accordance with Rule 12-04, Schedule I of Regulation S-X. These statements should be read in conjunction with the financial statements and the notes in Item 8. Financial Statements and Supplementary Data of the Annual Report on Form 10-K for the year ended December 31, 2016.

**2. Credit Agreements.**

As of December 31, 2016, MGE Energy had access to an unsecured, committed credit facility with aggregate bank commitments of \$50.0 million. At December 31, 2016, no borrowings were outstanding under this facility.

See Footnote 10 of the Notes to Consolidated Financial Statements for further information regarding MGE Energy's credit agreements.

**3. Commitments and Contingencies.**

See Footnote 17 of the Notes to Consolidated Financial Statements for commitments and contingencies.

**4. Dividends from Affiliates.**

<i>(In thousands)</i>	Dividends from Affiliates		
	2016	2015	2014
MGE <sup>(a)</sup> .....	\$ 50,000	\$ 30,000	\$ 26,500
MGE Power Elm Road.....	13,500	10,000	13,500
MGE Power West Campus .....	9,500	3,000	6,000
MGE Transco .....	1,107	1,708	1,859
Total .....	\$ 74,107	\$ 44,708	\$ 47,859

(a) Excludes \$15.8 million dividend in kind to MGE Energy from MGE.

***Dividend Restrictions***

Dividend payments by MGE to MGE Energy are subject to restrictions arising under a PSCW rate order and, to a lesser degree, MGE's first mortgage bonds. The PSCW order restricts any dividends, above the PSCW authorized amount of \$43 million, that MGE may pay MGE Energy if its common equity ratio, calculated in the manner used in the rate proceeding, is less than 55%. MGE's thirteen month rolling average common equity ratio at December 31, 2016, is 60.2% as determined under the calculation used in the rate proceeding. MGE was not restricted from paying cash dividends in 2016. Cash dividends of \$50.0 million and \$30.0 million were paid by MGE to MGE Energy in 2016 and 2015, respectively. In 2016, MGE also transferred its ownership interest in MGE Transco to MGE Energy in the form of a dividend in kind of \$15.8 million. The rate proceeding calculation includes as indebtedness imputed amounts for MGE's outstanding purchase power capacity payments and other PSCW adjustments, but does not include the indebtedness associated with MGE Power Elm Road or MGE Power West Campus, which are consolidated into MGE's financial statements but are not direct obligations of MGE.

MGE has covenanted with the holders of its first mortgage bonds not to declare or pay any dividend or make any other distribution on or purchase any shares of its common stock unless, after giving effect thereto, the aggregate amount of all such dividends and distributions and all amounts applied to such purchases, after December 31, 1945, shall not exceed the earned surplus (retained earnings) accumulated subsequent to December 31, 1945. As of December 31, 2016, approximately \$338.5 million was available for the payment of dividends under this covenant.

See Footnotes 9 and 10 of the Notes to Consolidated Financial Statements for long-term debt and lines of credit dividend restrictions.

**Schedule II**  
**MGE Energy, Inc. and Madison Gas and Electric Company**  
**Valuation and Qualifying Accounts**

	Balance at Beginning of Period	Additions		Net Accounts Written Off <sup>(a)</sup>	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
<b>Fiscal Year 2014:</b>					
Accumulated provision for uncollectibles	\$ 4,969,711	1,898,300	15,092	(2,134,446)	\$ 4,748,657
<b>Fiscal Year 2015:</b>					
Accumulated provision for uncollectibles	\$ 4,748,657	595,500	25,500	(1,675,577)	\$ 3,694,080
<b>Fiscal Year 2016:</b>					
Accumulated provision for uncollectibles	\$ 3,694,080	1,195,500	19,500	(1,465,784)	\$ 3,443,296

(a) Net of recovery of amounts previously written off.

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## Signatures - MGE Energy, Inc.

Pursuant to the requirements of Section 13 or 15(d) 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.**

(Registrant)

Date: February 24, 2017

/s/ Gary J. Wolter

Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 24, 2017.

/s/ Gary J. Wolter

Gary J. Wolter  
Chairman, President and Chief Executive Officer and Director  
(Principal Executive Officer)

/s/ Jeffrey C. Newman

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

/s/ Mark D. Bugher

Mark D. Bugher, Director

/s/ Londa J. Dewey

Londa J. Dewey, Director

/s/ F. Curtis Hastings

F. Curtis Hastings, Director

/s/ Regina M. Millner

Regina M. Millner, Director

/s/ John R. Nevin

John R. Nevin, Director

/s/ James L. Possin

James L. Possin, Director

/s/ Thomas R. Stolper

Thomas R. Stolper, Director

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## Signatures - Madison Gas and Electric Company

Pursuant to the requirements of Section 13 or 15(d) 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**  
(Registrant)

Date: February 24, 2017

/s/ Gary J. Wolter  
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 24, 2017.

/s/ Gary J. Wolter  
Gary J. Wolter  
Chairman, President and Chief Executive Officer and Director  
(Principal Executive Officer)

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

/s/ Mark D. Bugher  
Mark D. Bugher, Director

/s/ Londa J. Dewey  
Londa J. Dewey, Director

/s/ F. Curtis Hastings  
F. Curtis Hastings, Director

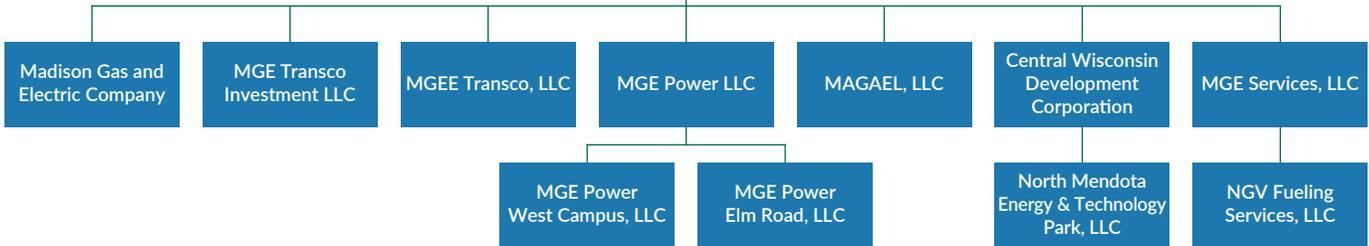
/s/ Regina M. Millner  
Regina M. Millner, Director

/s/ John R. Nevin  
John R. Nevin, Director

/s/ James L. Possin  
James L. Possin, Director

/s/ Thomas R. Stolper  
Thomas R. Stolper, Director

# Corporate profile



## MGE Energy, Inc.

MGE Energy is the parent company of Madison Gas and Electric Co. (MGE) and its divisions, which serve natural gas and electric customers in south-central and western Wisconsin.

MGE Transco Investment holds an ownership interest in ATC LLC, which invests in transmission assets, primarily within Wisconsin.

MGEE Transco LLC holds an ownership interest in ATC Holdco, which invests in transmission assets outside ATC LLC service territory.

MGE Power owns assets in the West Campus Cogeneration Facility at Madison, Wis., and the Elm Road Generating Station at Oak Creek, Wis.

MAGAEL holds title to properties acquired for future utility plant expansion.

Central Wisconsin Development Corp. promotes business growth in MGE's service area.

North Mendota Energy & Technology Park owns property and serves as the development entity for the property.

MGE Services provides construction and other services. Its subsidiary NGV Fueling Services, LLC, installs, owns and maintains equipment used to fuel natural gas-powered vehicles.

[Learn more at mgeenergy.com](http://mgeenergy.com)

## MGE Electric Services

**Generation and Distribution**  
 Customers: 149,000  
 Population: 319,500  
 Area: 316 square miles

**Communities served:** Cross Plains, Fitchburg, Madison, Maple Bluff, McFarland, Middleton, Monona and Shorewood Hills

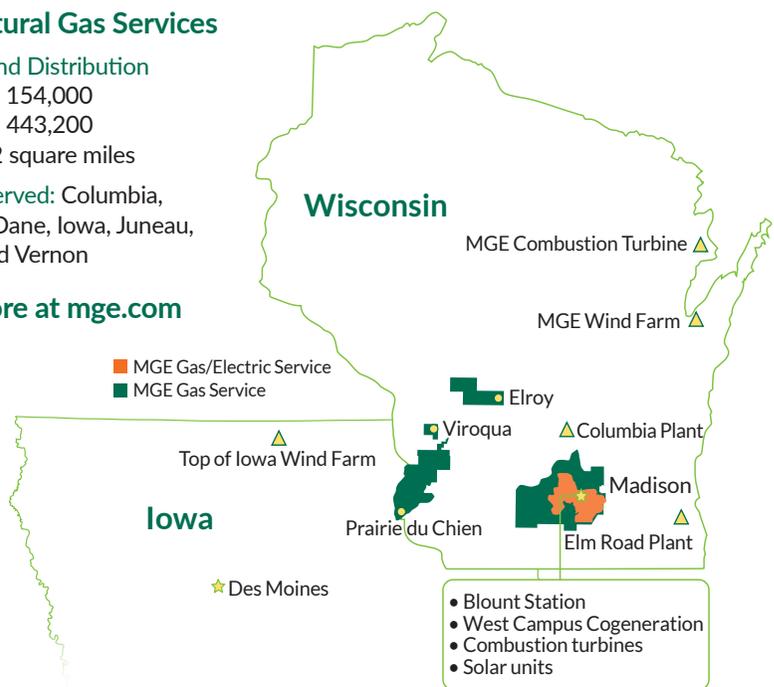
**Generating facilities:** Blount Station, West Campus Cogeneration Facility, combustion turbines and solar units at Madison, Columbia Energy Center at Portage, natural gas combustion turbine at Marinette, MGE wind farm in Kewaunee County, Top of Iowa Wind Farm in north-central Iowa and Elm Road Generating Station at Oak Creek

## MGE Natural Gas Services

**Purchase and Distribution**  
 Customers: 154,000  
 Population: 443,200  
 Area: 1,682 square miles

**Counties served:** Columbia, Crawford, Dane, Iowa, Juneau, Monroe and Vernon

[Learn more at mge.com](http://mge.com)





P.O. Box 1231  
Madison, WI 53701-1231



Learn more at [mgeenergy.com](https://www.mgeenergy.com)

MGE is committed to environmental stewardship. This report is printed on recycled paper.