MGE ENERGY INC
Form 10-Q
May 05, 2016

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended:

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

(a Wisconsin Corporation)

133 South Blair Street

Madison, Wisconsin 53788

(608) 252-7000

mge.com

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

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

Yes [X] No [ ]

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

	Large Accelerated Filer	**Accelerated Filer**	**Non-accelerated Filer**	**Smaller Reporting Company**
MGE Energy, Inc.	X			
Madison Gas and Electric Company			X	

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

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

Number of Shares Outstanding of Each Class of Common Stock as of April 30, 2016

MGE Energy, Inc.	Common stock, $1.00 par value, 34,668,370 shares outstanding.
Madison Gas and Electric Company	Common stock, $1.00 par value, 17,347,894 shares outstanding (all of which are owned beneficially and of record by MGE Energy, Inc.).

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PART I. FINANCIAL INFORMATION.

Filing Format

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

Forward-Looking Statements

This report, and other documents filed by MGE Energy and MGE with the Securities and Exchange Commission (SEC) from time to time, contain forward-looking statements that reflect management's current assumptions and estimates regarding future performance and economic conditions especially as they relate to 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 the Registrants' 2015 Annual Report on Form 10-K: Item 1A. Risk Factors, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, as updated by Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations in this report, and Item 8. Financial Statements and Supplementary Data Note 18, as updated by Part I, Item 1. Financial Statements Note 7 in this report, and (b) other factors discussed herein and in other filings made by that registrant with the SEC.

Readers are cautioned not to place undue reliance on these forward-looking statements, which apply only as of the date of this report. MGE Energy and MGE undertake no obligation to 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, MGE Energy's website at mgeenergy.com, and MGE's website at mge.com. Copies may be obtained from our websites free of charge. Information contained on MGE Energy's and MGE's websites shall not be deemed incorporated into, or to be a part of, this report.

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

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

MGE Energy and Subsidiaries:

CWDC	Central Wisconsin Development Corporation
MAGAEL	MAGAEL, LLC
MGE	Madison Gas and Electric Company
MGE 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
NGV Fueling Services	NGV Fueling Services, LLC
North Mendota	North Mendota Energy & Technology Park, LLC

Other Defined Terms:

AFUDC	Allowance for Funds Used During Construction
ATC	American Transmission Company LLC
BART	Best Available Retrofit Technology
Blount	Blount Station
CAVR	Clean Air Visibility Rule
CCR	Coal Combustion Residual
Codification	Financial Accounting Standards Board Accounting Standards Codification
Columbia	Columbia Energy Center
CPP	Clean Power Plan
CSAPR	Cross-State Air Pollution Rule
Dth	Dekatherms, a quantity measure used in respect of natural gas
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
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
kWh	Kilowatt-hour, a measure of electric energy produced
MISO	Midcontinent Independent System Operator (a regional transmission organization)

MW	Megawatt, a measure of electric energy generating capacity
MWh	Megawatt-hour, a measure of electric energy produced
NAAQS	National Ambient Air Quality Standards
NO_2	Nitrogen Dioxide
NOx	Nitrogen Oxides
PGA	Purchased Gas Adjustment clause, a regulatory mechanism used to reconcile natural gas costs recovered in rates to actual costs
PM	Particulate Matter
PPA	Purchased Power Agreement
ppb	Parts Per Billion
PSCW	Public Service Commission of Wisconsin
ROE	Return on Equity
SCR	Selective Catalytic Reduction
SEC	Securities and Exchange Commission
SO2	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
Working capital	Current assets less current liabilities
WPDES	Wisconsin Pollutant Discharge Elimination System
WPL	Wisconsin Power and Light Company
XBRL	eXtensible Business Reporting Language

Item 1. Financial Statements.

MGE Energy, Inc.

Consolidated Statements of Income (unaudited)

(In thousands, except per-share amounts)

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Operating Revenues:		
Electric revenues	$ 93,690	$ 100,206
Gas revenues	53,837	69,928
Total Operating Revenues	147,527	170,134
Operating Expenses:		
Fuel for electric generation	12,013	11,892
Purchased power	14,670	22,865
Cost of gas sold	32,523	46,919
Other operations and maintenance	42,730	40,674
Depreciation and amortization	11,032	10,849
Other general taxes	5,028	5,084
Total Operating Expenses	117,996	138,283
Operating Income	29,531	31,851
Other income, net	2,442	2,105
Interest expense, net	(5,000)	(5,091)
Income before income taxes	26,973	28,865
Income tax provision	(9,945)	(10,587)
Net Income	$ 17,028	$ 18,278
Earnings Per Share of Common Stock (basic and diluted)	$ 0.49	$ 0.53
Dividends per share of common stock	$ 0.295	$ 0.283
Average Shares Outstanding (basic and diluted)	34,668	34,668

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

MGE Energy, Inc.

Consolidated Statements of Comprehensive Income (unaudited)

(In thousands)

	Three Months Ended March 31,	
	2016	**2015**
Net Income	$ 17,028	$ 18,278
Other comprehensive income, net of tax:		
Unrealized loss on available-for-sale securities, net of tax ($110 and $57)	(164)	(85)
Comprehensive Income	$ 16,864	$ 18,193

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

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MGE Energy, Inc.

Consolidated Statements of Cash Flows (unaudited)

(In thousands)

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Operating Activities:		
Net income	$ 17,028	$ 18,278
Items not affecting cash:		
Depreciation and amortization	11,032	10,849
Deferred income taxes	2,840	3,723
Provision for doubtful receivables	592	97
Employee benefit plan expenses	(57)	792
Equity earnings in ATC	(2,233)	(1,881)
Other items	86	(658)
Changes in working capital items:		
Decrease in current assets	22,311	17,985
Increase (decrease) in current liabilities	1,487	(11,091)
Dividend income from ATC	865	1,420
Cash contributions to pension and other postretirement plans	(11,159)	(10,809)
Other noncurrent items, net	937	5,935
Cash Provided by Operating Activities	43,729	34,640
Investing Activities:		
Capital expenditures	(15,642)	(11,533)
Capital contributions to investments	(671)	(280)
Other	(183)	(48)
Cash Used for Investing Activities	(16,496)	(11,861)
Financing Activities:		
Cash dividends paid on common stock	(10,227)	(9,794)
Repayment of long-term debt	(1,059)	(1,037)
Repayment of short-term debt	-	(7,000)
Cash Used for Financing Activities	(11,286)	(17,831)
Change in cash and cash equivalents	15,947	4,948
Cash and cash equivalents at beginning of period	81,384	65,755
Cash and cash equivalents at end of period	$ 97,331	$ 70,703

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

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MGE Energy, Inc.

Consolidated Balance Sheets (unaudited)

(In thousands)

	March 31, 2016	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 97,331	$ 81,384
Accounts receivable, less reserves of $3,289 and $3,052, respectively	36,710	37,112
Other accounts receivable, less reserves of $569 and $642, respectively	5,637	7,477
Unbilled revenues	23,375	25,008
Materials and supplies, at average cost	20,335	19,155
Fossil fuel	10,222	13,110
Stored natural gas, at average cost	8,548	16,145
Prepaid taxes	24,606	35,252
Regulatory assets - current	10,448	9,538
Other current assets	9,992	10,570
Total Current Assets	247,204	254,751
Regulatory assets	149,987	148,199
Other deferred assets and other	6,476	6,377
Property, Plant, and Equipment:		
Property, plant, and equipment, net	1,218,282	1,217,094
Construction work in progress	33,198	26,351
Total Property, Plant, and Equipment	1,251,480	1,243,445
Investments	75,269	73,631
Total Assets	$ 1,730,416	$ 1,726,403
LIABILITIES AND CAPITALIZATION		
Current Liabilities:		
Long-term debt due within one year	$ 34,264	$ 4,266
Accounts payable	41,132	40,830
Accrued interest and taxes	3,975	5,067
Accrued payroll related items	8,926	11,215
Regulatory liabilities - current	11,071	9,515
Derivative liabilities	9,374	8,343
Other current liabilities	9,181	4,910
Total Current Liabilities	117,923	84,146
Other Credits:		
Deferred income taxes	363,671	360,785
Investment tax credit - deferred	1,024	1,050
Regulatory liabilities	21,493	20,785
Accrued pension and other postretirement benefits	64,259	75,680

Derivative liabilities		46,540		44,935
Other deferred liabilities and other		62,620		61,820
Total Other Credits		559,607		565,055
Capitalization:				
Common shareholders' equity		697,095		690,458
Long-term debt		355,791		386,744
Total Capitalization		1,052,886		1,077,202
Commitments and contingencies (see Footnote 7)		-		-
Total Liabilities and Capitalization	$	1,730,416	$	1,726,403

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

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MGE Energy, Inc.

Consolidated Statements of Common Equity (unaudited)

(In thousands, except per-share amounts)

	Common Stock Shares	Common Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
2015						
Beginning balance - December 31, 2014	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				18,278		18,278
Other comprehensive loss					(85)	(85)
Common stock dividends declared ($0.283 per share)				(9,794)		(9,794)
Ending balance - March 31, 2015	34,668	$ 34,668	$ 316,268	$ 316,349	$ 373	$ 667,658
2016						
Beginning balance - December 31, 2015	34,668	$ 34,668	$ 316,268	$ 339,165	$ 357	$ 690,458
Net income				17,028		17,028
Other comprehensive loss					(164)	(164)
Common stock dividends declared ($0.295 per share)				(10,227)		(10,227)
Ending balance - March 31, 2016	34,668	$ 34,668	$ 316,268	$ 345,966	$ 193	$ 697,095

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

Madison Gas and Electric Company

Consolidated Statements of Income (unaudited)

(In thousands)

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Operating Revenues:		
Electric revenues	$ 93,696	$ 100,211
Gas revenues	53,847	69,933
Total Operating Revenues	147,543	170,144
Operating Expenses:		
Fuel for electric generation	12,016	11,894
Purchased power	14,674	22,868
Cost of gas sold	32,534	46,923
Other operations and maintenance	42,402	40,472
Depreciation and amortization	11,020	10,837
Other general taxes	5,028	5,084
Income tax provision	9,090	9,776
Total Operating Expenses	126,764	147,854
Operating Income	20,779	22,290
Other Income and Deductions:		
AFUDC - equity funds	261	128
Equity in earnings in ATC	2,233	1,881
Income tax provision	(942)	(808)
Other expense, net	(73)	(39)
Total Other Income and Deductions	1,479	1,162
Income before interest expense	22,258	23,452
Interest Expense:		
Interest on long-term debt	5,109	5,151
Other interest, net	37	32
AFUDC - borrowed funds	(85)	(42)
Net Interest Expense	5,061	5,141
Net Income	$ 17,197	$ 18,311
Less Net Income Attributable to Noncontrolling Interest, net of tax	(6,252)	(6,553)
Net Income Attributable to MGE	$ 10,945	$ 11,758

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

Madison Gas and Electric Company

Consolidated Statements of Comprehensive Income (unaudited)

(In thousands)

	Three Months Ended March 31, 2016		Three Months Ended March 31, 2015	
Net Income	$	17,197	$	18,311
Other comprehensive income, net of tax:				
Unrealized loss on available-for-sale securities, net of tax ($20 and $55)		(30)		(82)
Comprehensive Income	$	17,167	$	18,229
Less: Comprehensive income attributable to Noncontrolling Interest, net of tax		(6,252)		(6,553)
Comprehensive Income attributable to MGE	$	10,915	$	11,676

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

Madison Gas and Electric Company

Consolidated Statements of Cash Flows (unaudited)

(In thousands)

	Three Months Ended March 31, 2016	2015
Operating Activities:		
Net income	$ 17,197	$ 18,311
Items not affecting cash:		
Depreciation and amortization	11,020	10,837
Deferred income taxes	2,502	2,391
Provision for doubtful receivables	592	97
Employee benefit plan expenses	(57)	792
Equity earnings in ATC	(2,233)	(1,881)
Other items	112	(526)
Changes in working capital items:		
Decrease in current assets	22,053	18,825
Increase (decrease) in current liabilities	1,524	(8,859)
Dividend income from ATC	865	1,420
Cash contributions to pension and other postretirement plans	(11,159)	(10,809)
Other noncurrent items, net	906	5,901
Cash Provided by Operating Activities	43,322	36,499
Investing Activities:		
Capital expenditures	(15,642)	(11,533)
Capital contributions to investments	(533)	(178)
Other	(72)	(17)
Cash Used for Investing Activities	(16,247)	(11,728)
Financing Activities:		
Cash dividends paid to parent by MGE	(10,000)	-
Distributions to parent from noncontrolling interest	(6,500)	(6,818)
Equity contribution received by noncontrolling interest	533	2,678
Repayment of long-term debt	(1,059)	(1,037)
Repayment of short-term debt	-	(7,000)
Cash Used for Financing Activities	(17,026)	(12,177)
Change in cash and cash equivalents	10,049	12,594
Cash and cash equivalents at beginning of period	26,760	4,562

Cash and cash equivalents at end of period	$	36,809	$	17,156

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

Madison Gas and Electric Company

Consolidated Balance Sheets (unaudited)

(In thousands)

	March 31, 2016	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 36,809	$ 26,760
Accounts receivable, less reserves of $3,289 and $3,052, respectively	36,710	37,112
Affiliate receivables	686	542
Other accounts receivable, less reserves of $569 and $642, respectively	5,522	7,390
Unbilled revenues	23,375	25,008
Materials and supplies, at average cost	20,335	19,155
Fossil fuel	10,222	13,110
Stored natural gas, at average cost	8,547	16,145
Prepaid taxes	23,764	34,279
Regulatory assets - current	10,448	9,538
Other current assets	9,978	10,544
Total Current Assets	186,396	199,583
Affiliate receivable long-term	4,633	4,766
Regulatory assets	149,987	148,199
Other deferred assets and other	4,219	4,216
Property, Plant, and Equipment:		
Property, plant, and equipment, net	1,217,614	1,216,415
Construction work in progress	33,198	26,351
Total Property, Plant, and Equipment	1,250,812	1,242,766
Investments	71,835	69,984
Total Assets	$ 1,667,882	$ 1,669,514
LIABILITIES AND CAPITALIZATION		
Current Liabilities:		
Long-term debt due within one year	$ 34,264	$ 4,266
Accounts payable	41,140	40,742
Accrued interest and taxes	3,927	5,021
Accrued payroll related items	8,926	11,215
Regulatory liabilities - current	11,071	9,515
Derivative liabilities	9,374	8,343
Other current liabilities	9,005	4,791
Total Current Liabilities	117,707	83,893
Other Credits:		
Deferred income taxes	355,264	352,626
Investment tax credit - deferred	1,024	1,050

Regulatory liabilities		21,493		20,785
Accrued pension and other postretirement benefits		64,259		75,680
Derivative liabilities		46,540		44,935
Other deferred liabilities and other		62,620		61,817
Total Other Credits		551,200		556,893
Capitalization:				
Common shareholder's equity		502,591		501,676
Noncontrolling interest		140,593		140,308
Total Equity		643,184		641,984
Long-term debt		355,791		386,744
Total Capitalization		998,975		1,028,728
Commitments and contingencies (see Footnote 7)		-		-
Total Liabilities and Capitalization	$	1,667,882	$	1,669,514

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

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Madison Gas and Electric Company

Consolidated Statements of Common Equity (unaudited)

(In thousands)

	Common Stock Shares	Common Stock Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Non-Controlling Interest	Total
2015							
Beginning balance - Dec. 31, 2014	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				11,758		6,553	18,311
Other comprehensive loss					(82)		(82)
Equity contribution received by noncontrolling interest						2,678	2,678
Distributions to parent from noncontrolling interest						(6,818)	(6,818)
Ending balance - March 31, 2015	17,348	$ 17,348	$ 192,417	$ 288,278	$ 62	$ 128,102	$ 626,207
2016							
Beginning balance - Dec. 31, 2015	17,348	$ 17,348	$ 192,417	$ 291,888	$ 23	$ 140,308	$ 641,984
Net income				10,945		6,252	17,197
Other comprehensive loss					(30)		(30)
Cash dividends paid to parent by MGE				(10,000)			(10,000)
Equity contribution received by noncontrolling interest						533	533
Distributions to parent from noncontrolling interest						(6,500)	(6,500)
Ending balance - March 31, 2016	17,348	$ 17,348	$ 192,417	$ 292,833	$ (7)	$ 140,593	$ 643,184

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

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

Notes to Consolidated Financial Statements (unaudited)

March 31, 2016

1.

Basis of Presentation - MGE Energy and MGE.

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

MGE Power Elm Road and MGE Power West Campus own electric generating assets and lease those assets to MGE. Both entities are variable interest entities under applicable authoritative accounting guidance. MGE is considered the primary beneficiary of these entities as a result of contractual agreements. As a result, MGE has consolidated MGE Power Elm Road and MGE Power West Campus. See Footnote 2 of Notes to Consolidated Financial Statements under Item 8, Financial Statements and Supplementary Data, of MGE Energy's and MGE's 2015 Annual Report on Form 10-K.

The accompanying consolidated financial statements as of March 31, 2016, and for the three months ended, are unaudited, but include all adjustments that MGE Energy and MGE management consider necessary for a fair statement of their respective financial statements. All adjustments are of a normal, recurring nature except as otherwise disclosed. The year-end consolidated balance sheet information was derived from the audited balance sheet appearing in MGE Energy's and MGE's 2015 Annual Report on Form 10-K, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These notes should be read in conjunction with the financial statements and the notes on pages 55 through 105 of the 2015 Annual Report on Form 10-K.

2.

Equity and Financing Arrangements - MGE Energy.

a.

Common Stock.

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 both the three months ended March 31, 2016 and 2015, MGE Energy did not issue any new shares of common stock under the Stock Plan.

b.

Dilutive Shares Calculation.

MGE Energy does not hold any dilutive securities.

3.

Investment in ATC - MGE Energy and MGE.

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

MGE Transco has accounted for its investment in ATC under the equity method of accounting. For the three months ended March 31, 2016 and 2015, MGE Transco recorded the following:

	Three Months Ended March 31,	
(In thousands)	2016	2015
Equity in earnings from investment in ATC	$ 2,233	$ 1,881
Dividends received from ATC	865	1,420
Capital contributions to ATC	533	178

MGE Transco's investment in ATC as of March 31, 2016, and December 31, 2015, was $71.4 million and $69.5 million, respectively.

At March 31, 2016, MGE is the majority owner (51%), and MGE Energy, the holding company, is the minority owner (49%) of MGE Transco. MGE Energy's proportionate share of the equity and net income of MGE Transco is classified within the MGE financial statements as noncontrolling interest. MGE's ownership interest is expected to decline below a majority during 2016 as a result of continued funding of ATC capital contributions by MGE Energy, and may be completely eliminated in favor of MGE Energy if the PSCW accepts a staff recommendation that MGE transfer its interest in ATC to MGE Energy. The recommendation arose in the context of requests for regulatory approvals by several owners of ATC in connection with a reorganization of ATC designed to separate its existing Wisconsin-based transmission operations from its non-Wisconsin transmission development activities. The change will have no effect on MGE Energy's consolidated financial statements. No gain or loss is expected to be recognized on the date MGE ceases to have a controlling financial interest.

ATC's summarized financial data for the three months ended March 31, 2016 and 2015, is as follows:

	Three Months Ended March 31,	
(In thousands)	2016	2015
Operating revenues	$ 164,240	$ 152,357
Operating expenses	(79,065)	(79,951)
Other income, net	127	62
Interest expense, net	(24,208)	(24,483)
Earnings before members' income taxes	$ 61,094	$ 47,985

4.

Taxes - MGE Energy and MGE.

Effective Tax Rate.

MGE Energy's effective income tax rate for the three months ended March 31, 2016 and 2015, was 36.9% and 36.7%, respectively. MGE's effective income tax rate for the three months ended March 31, 2016 and 2015, was 36.8% and 36.6%, respectively. The increase in the effective tax rate is due in part to a lower estimated domestic manufacturing deduction and lower estimated AFUDC equity earnings in 2016.

5.

Pension and Other Postretirement Plans - MGE Energy and MGE.

MGE maintains qualified and nonqualified pension plans, health care, and life insurance benefits. Additionally, MGE has defined contribution 401(k) benefit plans. MGE refined its methodology for using discount rates to measure the components of net periodic benefit cost for 2016. 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 following table presents the components of MGE Energy's and MGE's net periodic benefit costs recognized for the three months ended March 31, 2016 and 2015. A portion of the net periodic benefit cost is capitalized within the consolidated balance sheets.

	Three Months Ended March 31,	
(In thousands)	2016	2015
Pension Benefits		
Components of net periodic cost:		
Service cost	$ 1,381	$ 1,798
Interest cost	3,089	3,440
Expected return on assets	(5,593)	(5,677)
Amortization of:		
Prior service cost	2	6
Actuarial loss	1,356	1,334
Net periodic cost	$ 235	$ 901
Postretirement Benefits		
Components of net periodic (benefit) cost:		
Service cost	$ 324	$ 383
Interest cost	674	778
Expected return on assets	(705)	(703)
Amortization of:		
Transition obligation	1	1
Prior service benefit	(667)	(667)
Actuarial loss	159	262
Net periodic (benefit) cost	$ (214)	$ 54

6.

Share-Based Compensation - MGE Energy and MGE.

Under MGE Energy's Performance Unit Plan, 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 February 2016, 19,055 units were granted based on the MGE Energy closing stock price as of that date. Units are subject to a five-year graded vesting schedule. On the grant date, MGE Energy and MGE measure the cost of the employee services received in exchange for a performance unit award based on the current market value of MGE Energy common stock. The fair value of the awards is re-measured quarterly, including at March 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.

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.

Under the Director Incentive Plan, a non-employee director can 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 payments, at the end of the set performance period. The units are subject to a three-year graded vesting schedule. This plan is similar to MGE Energy's Performance Unit Plan for eligible employees described above. In January 2016, 3,773 units were granted.

During the three months ended March 31, 2016 and 2015, MGE recorded $1.3 million and $0.5 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 three months ended March 31, 2015, MGE recorded a $0.2 million gain on 4,676 units forfeited. No forfeitures occurred during the three months ended March 31, 2016. At March 31, 2016, $5.3 million of outstanding awards are vested, and of this amount, no cash settlements have occurred.

7.

Commitments and Contingencies - MGE Energy and MGE.

a.

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 we conduct our 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. These initiatives, proposed rules, and court challenges include:

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. WDNR is currently developing 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 studies showing that it will likely be in compliance with this rule when its WPDES permit is renewed in 2017. The operator of our Columbia plant plans to conduct 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.

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

In October 2015, the EPA published its Clean Power Plan (CPP) rule, which went into effect in 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. In October 2015, the EPA also published a proposed federal implementation plan under the CPP rule. The proposed federal implementation plan is designed to provide mass-based and rate-based emissions trading options to serve as a model and/or resource for states that are adopting their own plans, or for use by the EPA in states that do not implement their own plans under the finalized CPP. 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.

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. Oral arguments are scheduled before the D.C. Circuit for June 2, 2016.

Given the pending legal proceedings and the need for a yet-to-be-developed state implementation plan or finalization of the federal implementation plan, 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)

The EPA's NAAQS regulations have been developed to set ambient levels of six pollutants to protect sensitive populations (primary NAAQS) and the environment (secondary NAAQS) from the negative effects of exposure to these pollutants at higher levels. MGE is following developments for several NAAQS, including for particulate matter, nitrogen dioxide, sulfur dioxide, and ozone. Further discussion on sulfur dioxide, ozone, and nitrogen dioxide NAAQS follows. For additional information on the NAAQS process, see Footnote 18.c. of Notes to Consolidated Financial Statements under Item 8, Financial Statements and Supplementary Data, of MGE Energy's and MGE's 2015 Annual Report on Form 10-K.

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. 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 or may not attain them. It is too early to determine, however, as final attainment designations for these three counties will be based upon air monitoring data for years 2014-2016 and must be approved by the EPA. Once these designations are complete, the State of Wisconsin will develop implementation plans for each county designated as nonattainment, which could affect operations and emission control obligations for plants located within the nonattainment counties. 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. Briefings in this challenge began in April 2016 and will continue through the summer. The final briefs are scheduled to be filed in September 2016. MGE will continue to monitor legal developments, attainment designations, and any state actions and implementation plans.

Sulfur Dioxide (SO_2) NAAQS

In March 2015, the EPA entered into a court-approved consent decree requiring 1-hour SO_2 attainment/nonattainment area designations to be completed in three phases extending out until 2020. In August 2015, the EPA published its data requirements rule and under this new rule, states must submit their first designation proposals by July 2016 for those areas that contain large stationary sources of SO_2 (sources that emit over a threshold mass of SO_2, and/or over a threshold emissions rate). MGE's Columbia Plant was identified as one of these types of sources and thus Wisconsin is required to submit a designation proposal for Columbia County (the county in which the Columbia Plant is located). Wisconsin sent a designation proposal for Columbia County to the EPA on September 15, 2015. Wisconsin proposed that Columbia be considered in attainment based on recent SO_2 air emissions modeling that took newly installed pollution controls into account. In February 2016, the EPA sent a response letter to the State of Wisconsin indicating that it agreed with Wisconsin's recommended designations, and has given a preliminary classification of Columbia County as an unclassified/ attainment area. The EPA stated in their response letter that they intend to finalize designations by July 2, 2016. In addition to the EPA's actions on SO_2 NAAQS, the WDNR is revising its state rules to incorporate the one hour SO_2 standard with a proposed final rule date of August 2016. MGE will continue to monitor developments until final designations are made, however, we do not anticipate any material costs from this rule.

Nitrogen Dioxide (NO_2) NAAQS

The WDNR is revising its state rules to incorporate the EPA's one hour NO_2 NAAQS rule that was finalized in 2010. The anticipated effective date of the state rule is August 1, 2016. Wisconsin's NO_2 NAAQS rule may affect our stationary fossil-fuel generation sources by requiring that we demonstrate consistency with the NAAQS when applying for certain air permits. Preliminary assessments conducted by MGE suggest that these NAAQS rules will not have a material impact. MGE will continue to monitor rule developments.

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 (PM2.5) 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_2 and Nitrogen Oxides (NO_x) from fossil-fuel fired power plants. NO_x and SO_2 contribute to fine particulate pollution, and NO_x contributes to ozone. Reductions are achieved through a cap and trade model. Individual plants can meet their caps through modifications and/or buying allowances on the market.

In December 2015, the EPA published a proposed rule to amend the existing CSAPR. The proposed rule is designed to incorporate 2008 Ozone NAAQS attainment levels (the current CSAPR is based on 1997 Ozone NAAQS levels) in 23 states, including Wisconsin, by further limiting ozone season NO_x levels through a reduction in NO_x allowances. The proposed 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_x ozone season portion of the rule.

The proposed rule would reduce summertime NO_x emissions from power plants starting in 2017. Initial review of this proposed rule shows that we will likely need to buy NO_x Ozone Season allowances to comply with the rule. Depending on the cost of allowances, this requirement could be material for MGE. It is however too soon to tell what costs MGE will incur as the rule is not finalized, all legal proceedings are not completed, and the allowances are not on the market yet. We expect to monitor the rule developments and the D.C. Circuit Court remand completion to help determine how this rule will ultimately affect MGE.

Clean Air Visibility Rule (CAVR)

Columbia may be subject to the best available retrofit technology (BART) regulations, a subsection of the EPA's Clean Air Visibility Rule (CAVR), which may require pollution control retrofits. Columbia's 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. In February 2016, the EPA submitted a proposed revision to the CAVR. The proposed revision would move state plan due dates from July 2018 to July 2021. This would allow for states to coordinate their CAVR compliance with other compliance efforts. If this proposed revision is finalized, it would reduce the chances that CAVR would be material for MGE. At this time, however, the BART regulatory obligations, compliance strategies, and costs remain uncertain due to the continued legal uncertainty surrounding CSAPR.

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 determine what changes may be necessary at those facilities to meet design criteria. We anticipate that some design and operational changes may need to be made at these facilities. Review of our Elm Road facility 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.

b.

Legal Matters.

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.

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c.

Purchase Contracts.

MGE Energy and MGE have entered into various commodity transportation and storage contracts to meet their obligations to deliver natural gas to customers. As of March 31, 2016, the future commitments related to these purchase contracts were as follows:

(In thousands)	**2016**	**2017**	**2018**	**2019**	**2020**
Natural gas transportation & storage[(a)]	$ 14,000	$ 24,902	$ 24,833	$ 23,048	$ 16,274

(a)

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.

8.

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 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:

	March 31, 2016	December 31, 2015
Commodity derivative contracts	468,590 MWh	355,580 MWh
Commodity derivative contracts	2,317,500 Dth	5,037,500 Dth
FTRs	770 MW	2,000 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 March 31, 2016, and December 31, 2015, the cost basis of exchange traded derivatives and FTRs exceeded their fair value by $1.0 million and $0.8 million, respectively.

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 March 31, 2016, and December 31, 2015, reflects a loss position of $55.9 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. At March 31, 2016, MGE Energy and MGE had the right to reclaim collateral (a receivable) of $1.0 million.

	Asset Derivatives		Liability Derivatives	
(In thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
March 31, 2016				
Commodity derivative contracts	Other current assets	$ 441	Derivative liability (current)	$ 1,303
Commodity derivative contracts	Other deferred charges	53	Derivative liability (long-term)	184
FTRs	Other current assets	19	Derivative liability (current)	-
PPA	N/A	N/A	Derivative liability (current)	9,370
PPA	N/A	N/A	Derivative liability (long-term)	46,540
December 31, 2015				
Commodity derivative contracts	Other current assets	$ 146	Derivative liability (current)	$ 1,266
Commodity derivative contracts	Other deferred charges	144	Derivative liability (long-term)	70
FTRs	Other current assets	234	Derivative liability (current)	-
PPA	N/A	N/A	Derivative liability (current)	8,340
PPA	N/A	N/A	Derivative liability (long-term)	44,930

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

(In thousands)	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
March 31, 2016				
Commodity derivative contracts	$ 494	$ (494)	$ -	$ -
FTRs	19	-	-	19
December 31, 2015				
Commodity derivative contracts	$ 290	$ (290)	$ -	$ -
FTRs	234	-	-	234

Offsetting of Derivative Liabilities

(In thousands)	Gross Amounts	Gross Amounts Offset in Balance Sheets	Collateral Posted Against Derivative Positions	Net Amount Presented in Balance Sheets
March 31, 2016				
Commodity derivative contracts	$ 1,487	$ (494)	$ (989)	$ 4
PPA	55,910	-	-	55,910
December 31, 2015				
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 March 31, 2016 and 2015, and the consolidated income statements for the three months ended March 31, 2016 and 2015.

	2016		2015	
(In thousands)	Current and Long-Term Regulatory Asset	Other Current Assets	Current and Long-Term Regulatory Asset	Other Current Assets
Three Months Ended March 31:				
Balance at January 1,	$ 54,083	$ 1,208	$ 54,998	$ 1,001
Unrealized loss	6,370	-	1,318	-
Realized (loss) gain reclassified to a deferred account	(1,451)	1,451	(1,061)	1,061
Realized loss reclassified to income statement	(2,118)	(2,004)	(1,289)	(1,794)
Balance at March 31,	$ 56,884	$ 655	$ 53,966	$ 268

	Realized losses (gains)			
	2016		2015	
(In thousands)	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold	Fuel for Electric Generation/ Purchased Power	Cost of Gas Sold
Three Months Ended March 31:				
Commodity derivative contracts	$ 1,007	$ 1,814	$ 420	$ 1,761
FTRs	(68)	-	(119)	-
PPA	1,369	-	1,021	-

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 March 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 March 31, 2016, and 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 March 31, 2016, no counterparties have defaulted.

9.

Rate Matters - MGE Energy and MGE.

a.

Rate Proceedings.

In April 2016, MGE filed an application with the PSCW requesting a 1.7% increase to electric rates and a 3.7% increase to gas rates for 2017. The proposed electric and gas rate increases cover costs primarily associated with the state's electric transmission and MGE's natural gas system infrastructure improvements. In its application, MGE has also proposed mechanisms to address potential 2018 electric and gas rate changes, including a rate adjustment for limited issues and escrow accounting on certain costs.

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 will allow MGE to reflect any differential between transmission costs reflected in rates and actual costs incurred in its next rate case filing, which occurred in the April 2016 filing.

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 is 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.

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 is determined on an annual basis and is adjusted in future billings to electric retail customers. The fuel rules bandwidth is currently set at plus or minus 2%. Under fuel rules, MGE would defer costs, less any excess revenues, if its actual electric fuel costs exceeded 102% of the electric fuel costs allowed in its latest rate order. Excess revenues are defined as revenues in the year in question that provide MGE with a greater return on common equity than authorized by the PSCW in MGE's latest rate order. Conversely, MGE is required to defer the benefit of lower costs if actual electric fuel costs were less than 98% of the electric fuel costs allowed in that order.

In August 2015, the PSCW approved a $0.00256/kWh fuel credit that began on September 1, 2015, and will continue throughout 2016. The fuel credit established a mechanism to return fuel savings to electric customers as a bill credit. MGE returned $2.6 million of electric fuel-related savings in customer bill credits during the period from September 1, 2015, through December 31, 2015. MGE returned $1.9 million of electric fuel-related savings for the three months ended March 31, 2016. As of December 31, 2015, and March 31, 2016, MGE has a remaining deferred balance of $9.5 million and $7.6 million of electric fuel-related savings that are outside the range authorized by the PSCW, respectively. These costs are subject to PSCW's annual review, expected to be completed in 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. The return of the fuel savings to customers for 2016 will be addressed during the PSCW's annual review during 2016 of 2015 fuel costs. MGE will defer these fuel savings until a determination is made by the PSCW. As of March 31, 2016, MGE has deferred $3.6 million of these 2016 electric fuel rules monitored costs.

10.

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 March 31, 2016, and December 31, 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 March 31, 2016, and December 31, 2015. Since long-term debt is not traded in an active market, it is classified as Level 2. The estimated fair market value of MGE Energy's and MGE's financial instruments are as follows:

	March 31, 2016		December 31, 2015	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
MGE Energy				
Assets:				
Cash and cash equivalents	$ 97,331	$ 97,331	$ 81,384	$ 81,384
Liabilities:				
Long-term debt*	394,450	459,213	395,508	435,767
MGE				
Assets:				
Cash and cash equivalents	$ 36,809	$ 36,809	$ 26,760	$ 26,760
Liabilities:				
Long-term debt*	394,450	459,213	395,508	435,767

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

b.

Recurring Fair Value Measurements.

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

	Fair Value as of March 31, 2016			
(In thousands)	Total	Level 1	Level 2	Level 3
MGE Energy				
Assets:				

Derivatives, net[(a)]	$	236	$	217	$	-	$	19
Exchange-traded investments		485		485		-		-
Total Assets	$	721	$	702	$	-	$	19
Liabilities:								
Derivatives, net[(a)]	$	57,120	$	-	$	-	$	57,120
Deferred compensation		3,228		-		3,228		-
Total Liabilities	$	60,348	$	-	$	3,228	$	57,120
MGE								
Assets:								
Derivatives, net[(a)]	$	236	$	217	$	-	$	19
Exchange-traded investments		99		99		-		-
Total Assets	$	335	$	316	$	-	$	19
Liabilities:								
Derivatives, net[(a)]	$	57,120	$	-	$	-	$	57,120
Deferred compensation		3,228		-		3,228		-
Total Liabilities	$	60,348	$	-	$	3,228	$	57,120

(In thousands)	Fair Value as of December 31, 2015 Total	Level 1	Level 2	Level 3
MGE Energy				
Assets:				
Derivatives, net	$ 234	$ -	$ -	$ 234
Exchange-traded investments	759	759	-	-
Total Assets	$ 993	$ 759	$ -	$ 234
Liabilities:				
Derivatives, net[(a)]	$ 54,316	$ 581	$ -	$ 53,735
Deferred compensation	3,145	-	3,145	-
Total Liabilities	$ 57,461	$ 581	$ 3,145	$ 53,735
MGE				
Assets:				
Derivatives, net	$ 234	$ -	$ -	$ 234
Exchange-traded investments	148	148	-	-
Total Assets	$ 382	$ 148	$ -	$ 234
Liabilities:				
Derivatives, net[(a)]	$ 54,316	$ 581	$ -	$ 53,735
Deferred compensation	3,145	-	3,145	-
Total Liabilities	$ 57,461	$ 581	$ 3,145	$ 53,735

(a)

These amounts are shown gross and exclude $1.0 million of collateral that was posted against derivative positions with counterparties as of March 31, 2016, and December 31, 2015.

No transfers were made in or out of Level 1 or Level 2 for the three months ended March 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 8) 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.

	Model Input	
Significant Unobservable Inputs	March 31, 2016	December 31, 2015
Basis adjustment:		
On peak	96.7%	96.9%
Off peak	95.9%	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 for both MGE Energy and MGE.

	Three Months Ended March 31,	
(In thousands)	2016	2015
Beginning balance	$ (53,501)	$ (53,986)
Realized and unrealized gains (losses):		
Included in regulatory (assets) liabilities	(3,600)	119
Included in other comprehensive income	-	-
Included in earnings	(2,163)	(1,328)
Included in current assets	-	-
Purchases	5,301	6,162
Sales	-	-
Issuances	-	-
Settlements	(3,138)	(4,833)
Transfers in and/or out of Level 3	-	-
Balance as of March 31,	$ (57,101)	$ (53,866)
Total gains (losses) included in earnings attributed to the change in unrealized gains (losses) related to assets and liabilities held at March 31,[b]	$ -	$ -

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

	Three Months Ended March 31,	
(In thousands)	2016	2015
Purchased Power Expense	$ (2,163)	$ (1,328)

(b)

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.

11.

New 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. This authoritative guidance will become effective January 1, 2018. MGE Energy and MGE are currently assessing the impact this pronouncement will have on their 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 sheet. As of March 31, 2016, assets (other deferred assets and other) and liabilities (long-term debt) decreased approximately $4.2 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. The impact of this guidance on our financial statements is not expected to be material.

e.

Leases.

In February 2016, the FASB issued authoritative guidance within the Leases topic that provides guidance on the classification, recognition, measurement, and disclosure of leases. This authoritative guidance will become effective January 1, 2019. MGE Energy and MGE are currently assessing the impact this pronouncement will have on their financial statements.

12.

Segment Information - MGE Energy and MGE.

MGE Energy operates in the following business segments: electric utility, gas utility, nonregulated energy, transmission investment, and all other. See MGE Energy's and MGE's 2015 Annual Report on Form 10-K for additional discussion of each of these segments.

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

(In thousands) **MGE Energy**	Electric	Gas	Nonregulated Energy	Transmission Investment	All Others	Consolidation/ Elimination Entries	Consolidated Total
Three Months Ended March 31, 2016							
Operating revenues	$ 93,208	$ 53,837	$ 482	$ -	$ -	$ -	$ 147,527
Interdepartmental revenues	456	5,097	10,977	-	-	(16,530)	-
Total operating revenues	93,664	58,934	11,459	-	-	(16,530)	147,527
Depreciation and amortization	(7,163)	(1,981)	(1,876)	-	(12)	-	(11,032)
Other operating expenses	(75,379)	(47,741)	(47)	(1)	(326)	16,530	(106,964)
Operating income (loss)	11,122	9,212	9,536	(1)	(338)	-	29,531
Other (deductions) income, net	196	(8)	-	2,233	21	-	2,442
Interest (expense) income, net	(2,790)	(808)	(1,463)	-	61	-	(5,000)
Income (loss) before taxes	8,528	8,396	8,073	2,232	(256)	-	26,973
Income tax (provision) benefit	(2,536)	(3,359)	(3,240)	(897)	87	-	(9,945)
Net income (loss)	$ 5,992	$ 5,037	$ 4,833	$ 1,335	$ (169)	$ -	$ 17,028
Three Months Ended March 31, 2015							
Operating revenues	$ 98,240	$ 69,928	$ 1,966	$ -	$ -	$ -	$ 170,134
Interdepartmental revenues	115	2,725	9,847	-	-	(12,687)	-
Total operating revenues	98,355	72,653	11,813	-	-	(12,687)	170,134
Depreciation and amortization	(7,332)	(1,642)	(1,863)	-	(12)	-	(10,849)
Other operating expenses	(79,800)	(60,068)	(50)	-	(203)	12,687	(127,434)
Operating income (loss)	11,223	10,943	9,900	-	(215)	-	31,851
Other (deductions) income, net	90	(1)	-	1,881	135	-	2,105
Interest (expense) income, net	(2,819)	(804)	(1,518)	-	50	-	(5,091)
Income (loss) before taxes	8,494	10,138	8,382	1,881	(30)	-	28,865
Income tax provision	(2,383)	(4,081)	(3,364)	(756)	(3)	-	(10,587)

Net income (loss)	$ 6,111	$ 6,057	$ 5,018	$ 1,125	$ (33)	$ -	$ 18,278

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

(In thousands) **MGE**	Electric	Gas	Nonregulated Energy	Transmission Investment	Consolidation/ Elimination Entries	Consolidated Total
Three Months Ended March 31, 2016						
Operating revenues	$ 93,214	$ 53,847	$ 482	$ -	$ -	$ 147,543
Interdepartmental revenues	450	5,087	10,977	-	(16,514)	-
Total operating revenues	93,664	58,934				