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ALLETE INC
Form 10-K
February 13, 2009

United States
Securities and Exchange Commission
Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

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. 1-3548

ALLETE, Inc.

(Exact name of registrant as specified in its charter)

Minnesota

41-0418150

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

30 West Superior Street, Duluth, Minnesota 55802-2093
(Address of principal executive offices, including zip code)
(218) 279-5000

(Registrant's telephone number, including area code)
Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Stock Exchange on Which Registered
Common Stock, without par value	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

Indicate by check mark whether the registrant (1) has 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

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 registrant's 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Act).

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

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

Yes No

The aggregate market value of voting stock held by nonaffiliates on June 30, 2008, was \$1,293,602,666.

As of February 1, 2009, there were 32,624,876 shares of ALLETE Common Stock, without par value, outstanding.

Documents Incorporated By Reference

Portions of the Proxy Statement for the 2009 Annual Meeting of Shareholders are incorporated by reference in Part III.

Index

Definitions	3
Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995	5
Part I	
Item 1.	6
Business	6
Regulated Operations	6
Electric Sales / Customers	6
Power Supply	9
Transmission and Distribution	11
Investment in ATC	11
Properties	11
Regulatory Matters	12
Regional Organizations	13
Minnesota Legislation	14
Competition	14
Franchises	14
Investments and Other	15
BNI Coal	15
ALLETE Properties	15
Non-Rate Base Generation	16
Other	16
Environmental Matters	16
Employees	18
Availability of Information	18
Executive Officers of the Registrant	19
Item 1A.	20
Risk Factors	20
Item 1B.	23
Unresolved Staff Comments	23
Item 2.	23
Properties	23
Item 3.	23
Legal Proceedings	23
Item 4.	23
Submission of Matters to a Vote of Security Holders	23
Part II	
Item 5.	23
Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	23
Item 6.	24
Selected Financial Data	24
Item 7.	25
Management's Discussion and Analysis of Financial Condition and Results of Operations	25
Overview	25
2008 Compared to 2007	25
2007 Compared to 2006	27
Critical Accounting Estimates	29
Outlook	31
Liquidity and Capital Resources	37
Capital Requirements	40
Environmental and Other Matters	40
Market Risk	40

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	New Accounting Standards	41
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	41
Item 8.	Financial Statements and Supplementary Data	41
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	41
Item 9A.	Controls and Procedures	42
Item 9B.	Other Information	42
Part III		
Item 10.	Directors, Executive Officers and Corporate Governance	43
Item 11.	Executive Compensation	43
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	43
Item 13.	Certain Relationships and Related Transactions, and Director Independence	43
Item 14.	Principal Accounting Fees and Services	43
Part IV		
Item 15.	Exhibits and Financial Statement Schedules	44
Signatures		48
Consolidated Financial Statements		50

ALLETE 2008 Form 10-K

Definitions

The following abbreviations or acronyms are used in the text. References in this report to “we,” “us” and “our” are to ALLETE, Inc. and its subsidiaries, collectively.

Abbreviation or Acronym	Term
AICPA	American Institute of Certified Public Accountants
ALLETE	ALLETE, Inc.
ALLETE Properties	ALLETE Properties, LLC and its subsidiaries
AFUDC	Allowance for Funds Used During Construction - the cost of both debt and equity funds used to finance utility plant additions during construction periods
AREA	Arrowhead Regional Emission Abatement
ATC	American Transmission Company LLC
BNI Coal	BNI Coal, Ltd.
Boswell	Boswell Energy Center
Company	ALLETE, Inc. and its subsidiaries
DRI	Development of Regional Impact
EITF	Emerging Issues Task Force
EPA	Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Form 8-K	ALLETE Current Report on Form 8-K
Form 10-K	ALLETE Annual Report on Form 10-K
Form 10-Q	ALLETE Quarterly Report on Form 10-Q
FSP	Financial Accounting Standards Board Staff Position
GAAP	Accounting Principles Generally Accepted in the United States
GHG	Greenhouse Gas
Heating Degree Days	Measure of the extent to which the average daily temperature is below 65 degrees Fahrenheit, increasing demand for heating
Invest Direct	ALLETE's Direct Stock Purchase and Dividend Reinvestment Plan
kV	Kilovolt(s)
Laskin	Laskin Energy Center
Manitoba Hydro	Manitoba Hydro-Electric Board
MBtu	Million British thermal units
Mesabi Nugget	Mesabi Nugget Delaware, LLC
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MISO	Midwest Independent Transmission System Operator, Inc.
Moody's	Moody's Investors Service, Inc.
MPCA	Minnesota Pollution Control Agency
MPUC	Minnesota Public Utilities Commission
MW / MWh	Megawatt(s) / Megawatt-hour(s)
NextEra Energy	NextEra Energy Resources, LLC
Non-residential	Retail commercial, non-retail commercial, office, industrial, warehouse, storage and institutional
NOX	Nitrogen Oxide

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Note ____	Note ____ to the consolidated financial statements in this Form 10-K
NPDES	National Pollutant Discharge Elimination System
NYSE	New York Stock Exchange
OES	Minnesota Office of Energy Security

ALLETE 2008 Form 10-K

3

Definitions (Continued)

Abbreviation or Acronym	Term
Oliver Wind I	Oliver Wind I Energy Center
Oliver Wind II	Oliver Wind II Energy Center
Palm Coast Park	Palm Coast Park development project in Florida
Palm Coast Park District	Palm Coast Park Community Development District
PolyMet Mining	PolyMet Mining Corp.
PSCW	Public Service Commission of Wisconsin
PUHCA 2005	Public Utility Holding Company Act of 2005
Rainy River Energy	Rainy River Energy Corporation - Wisconsin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards No.
SO ₂	Sulfur Dioxide
Square Butte	Square Butte Electric Cooperative
Standard & Poor's	Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
Taconite Ridge	Taconite Ridge Energy Center
Town Center	Town Center at Palm Coast development project in Florida
Town Center District	Town Center at Palm Coast Community Development District
WDNR	Wisconsin Department of Natural Resources

ALLETE 2008 Form 10-K

Safe Harbor Statement
Under the Private Securities Litigation Reform Act of 1995

Statements in this report that are not statements of historical facts may be considered “forward-looking” and, accordingly, involve risks and uncertainties that could cause actual results to differ materially from those discussed. Although such forward-looking statements have been made in good faith and are based on reasonable assumptions, there is no assurance that the expected results will be achieved. Any statements that express, or involve discussions as to, future expectations, risks, beliefs, plans, objectives, assumptions, events, uncertainties, financial performance or growth strategies (often, but not always, through the use of words or phrases such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “projects,” “will likely results,” “will continue,” “could,” “may,” “potential,” “target,” “outlook” or similar meaning) are not statements of historical facts and may be forward-looking.

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are hereby filing cautionary statements identifying important factors that could cause our actual results to differ materially from those projected, or expectations suggested, in forward-looking statements made by or on behalf of ALLETE in this Annual Report on Form 10-K, in presentations, on our website, in response to questions or otherwise. These statements are qualified in their entirety by reference to, and are accompanied by, the following important factors, in addition to any assumptions and other factors referred to specifically in connection with such forward-looking statements:

- our ability to successfully implement our strategic objectives;
- our ability to manage expansion and integrate acquisitions;
- prevailing governmental policies, regulatory actions, and legislation including those of the United States Congress, state legislatures, the FERC, the MPUC, the PSCW, and various local and county regulators, and city administrators, about allowed rates of return, financings, industry and rate structure, acquisition and disposal of assets and facilities, real estate development, operation and construction of plant facilities, recovery of purchased power, capital investments and other expenses, present or prospective wholesale and retail competition (including but not limited to transmission costs), zoning and permitting of land held for resale and environmental matters;
- the potential impacts of climate change and future regulation to restrict the emissions of GHG on our Regulated Operations;
- effects of restructuring initiatives in the electric industry;
- economic and geographic factors, including political and economic risks;
- changes in and compliance with laws and regulations;
- weather conditions;
- natural disasters and pandemic diseases;
- war and acts of terrorism;
- wholesale power market conditions;
- population growth rates and demographic patterns;
- effects of competition, including competition for retail and wholesale customers;
- changes in the real estate market;
- pricing and transportation of commodities;
- changes in tax rates or policies or in rates of inflation;
- project delays or changes in project costs;
- availability and management of construction materials and skilled construction labor for capital projects;
- changes in operating expenses, capital and land development expenditures;
- global and domestic economic conditions affecting us or our customers;

- our ability to access capital markets and bank financing;
- changes in interest rates and the performance of the financial markets;
- our ability to replace a mature workforce and retain qualified, skilled and experienced personnel; and
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements that affect the business and profitability of ALLETE.

Additional disclosures regarding factors that could cause our results and performance to differ from results or performance anticipated by this report are discussed in Item 1A under the heading “Risk Factors” beginning on page 20 of this Form 10-K. Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which that statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for management to predict all of these factors, nor can it assess the impact of each of these factors on the businesses of ALLETE or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement. Readers are urged to carefully review and consider the various disclosures made by us in this Form 10-K and in our other reports filed with the SEC that attempt to advise interested parties of the factors that may affect our business.

ALLETE 2008 Form 10-K

Part I

Item 1. Business

In the fourth quarter of 2008, we made changes to our reportable business segments which are now comprised of Regulated Operations and Investments and Other. For additional information about our business segments, see Note 2.

Regulated Operations includes our regulated utilities, Minnesota Power and SWL&P, as well as our investment in ATC, a Wisconsin-based utility that owns and maintains electric transmission assets in parts of Wisconsin, Michigan, Minnesota and Illinois. Minnesota Power provides regulated utility electric service in northeastern Minnesota to 142,000 retail customers and wholesale electric service to 16 municipalities. SWL&P provides regulated electric service, natural gas and water service in northwestern Wisconsin to 15,000 electric customers, 12,000 natural gas customers and 10,000 water customers. Our regulated utility operations include retail and wholesale activities under the jurisdiction of state and federal regulatory authorities. (See Item 1. Business – Regulated Operations – Regulatory Matters.)

Investments and Other is comprised primarily of BNI Coal, our coal mining operations in North Dakota, and ALLETE Properties, our Florida real estate business. This segment also includes emerging technology investments (\$7.4 million at December 31, 2008), a small amount of non-rate base generation, approximately 7,000 acres of land for sale in Minnesota, and earnings on cash and short-term investments.

ALLETE is incorporated under the laws of Minnesota. Our corporate headquarters are in Duluth, Minnesota. Statistical information is presented as of December 31, 2008, unless otherwise indicated. All subsidiaries are wholly owned unless otherwise specifically indicated. References in this report to “we,” “us” and “our” are to ALLETE and its subsidiaries, collectively.

Year Ended December 31	2008	2007	2006
Consolidated Operating Revenue – Millions	\$801.0	\$841.7	\$767.1
Percentage of Consolidated Operating Revenue			
Regulated Operations	89	86	83
Investments and Other	11	14	17
	100%	100%	100%

For a detailed discussion of results of operations and trends, see Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations. For business segment information, see Note 1. Operations and Significant Accounting Policies and Note 2. Business Segments.

REGULATED OPERATIONS

Electric Sales / Customers

Regulated Utility Electric Sales	2008		2007		2006	
Year Ended December 31	2008	%	2007	%	2006	%
Millions of Kilowatt-hours						
Retail and Municipals						

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Residential	1,172	9	1,141	9	1,100	9
Commercial	1,454	12	1,456	11	1,420	11
Industrial	7,192	57	7,054	55	7,206	56
Municipals (FERC rate regulated)	1,002	8	1,009	8	905	7
	10,820	86	10,660	83	10,631	83
Other Power Suppliers	1,800	14	2,157	17	2,153	17
	12,620	100	12,817	100	12,784	100

ALLETE 2008 Form 10-K

REGULATED OPERATIONS (Continued)

Industrial Customers. In 2008, our industrial customers represented 57 percent of total regulated utility kilowatt-hour sales. Our industrial customers are primarily in the taconite, paper, pulp, wood products and pipeline industries.

Industrial Customer Electric Sales						
Year Ended December 31	2008	%	2007	%	2006	%
Millions of Kilowatt-hours						
Taconite Producers	4,579	64	4,408	62	4,517	63
Paper, Pulp and Wood Products	1,567	22	1,613	23	1,689	23
Pipelines	582	8	562	8	550	8
Other Industrial	464	6	471	7	450	6
	7,192	100	7,054	100	7,206	100

Approximately 60 percent of the ore consumed by integrated steel facilities in the United States originates from six taconite customers of Minnesota Power, which represent 4,579 kilowatt-hours, or 64 percent, of our total industrial sales in 2008. Taconite, an iron-bearing rock of relatively low iron content, is abundantly available in Minnesota and an important domestic source of raw material for the steel industry. Taconite processing plants use large quantities of electric power to grind the iron-bearing rock, and agglomerate and pelletize the iron particles into taconite pellets. Strong worldwide steel demand, driven largely by extensive infrastructure development in China, resulted in very robust world iron ore demand and steel pricing for nearly a six-year period which lasted through the summer of 2008. Beginning in the fall of 2008, worldwide steel producers began to dramatically cut steel production in response to reduced demand driven largely by the world credit situation. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Outlook.)

In addition to serving the taconite industry, Minnesota Power also serves a number of customers in the paper, pulp and wood products industry, which represent 1,567 kilowatt-hours, or 22 percent, of our total industrial sales in 2008. In total, we serve four major paper and pulp mills directly and one paper mill indirectly by providing wholesale service to the retail provider of the mill. Minnesota Power also serves three wood product manufacturers.

Minnesota Power's paper and pulp customers ran at, or very near, full capacity for the majority of 2008 despite the fact that the industry continued to face high fiber, chemical, and energy costs as well as competition from exports in certain grades of paper products. Minnesota Power's customers benefited from the temporary or permanent idling of plants both in North America at mills other than those served by Minnesota Power and the idling of plants in Europe, as well as continued (but declining) strength of the Canadian dollar and the Euro which has reduced imports both from Canada and Europe.

The pipeline industry is the third key industrial segment served by Minnesota Power with services provided to two crude oil pipelines and one refinery, which represent 582 kilowatt-hours, or 8 percent, of our total industrial sales in 2008. These customers have a common reliance on the importation of Canadian crude oil. After near capacity operations in 2006, 2007, and 2008, both pipeline operators are executing expansion plans to transport Western Canadian crude oil reserves (Alberta Oil Sands) to United States markets. Access to traditional Midwest markets is being expanded to Southern markets as the Canadian supply is displacing domestic production and deliveries imported from the Gulf Coast.

Large Power Customer Contracts. Minnesota Power has contracts with 12 Large Power Customers, 11 of which require 10 MWs or more of generating capacity and one that requires at least 8 MWs of generating capacity. These customers consist of six taconite producing facilities (two of which are owned by one company and are served under a

single contract), four paper and pulp mills, two pipeline companies and one manufacturer.

Large Power Customer contracts require Minnesota Power to have a certain amount of generating capacity available. In turn, each Large Power Customer is required to pay a minimum monthly demand charge that covers the fixed costs associated with having this capacity available to serve the customer, including a return on common equity. Most contracts allow customers to establish the level of megawatts subject to a demand charge on a four-month basis and require that a portion of their megawatt needs be committed on a take-or-pay basis for at least a portion of the agreement. In addition to the demand charge, each Large Power Customer is billed an energy charge for each kilowatt-hour used that recovers the variable costs incurred in generating electricity. Four of the Large Power Customers have interruptible service which provides a discounted demand rate for the ability to interrupt the customers during system emergencies. Minnesota Power also provides incremental production service for customer demand levels above the contractual take-or-pay levels. There is no demand charge for this service and energy is priced at an increment above Minnesota Power's cost. Incremental production service is interruptible.

All contracts with Large Power Customers continue past the contract termination date unless the required advance notice of cancellation has been given. The advance notice of cancellation varies from one to four years. Such contracts minimize the impact on earnings that otherwise would result from significant reductions in kilowatt-hour sales to such customers. Large Power Customers are required to take all of their purchased electric service requirements from Minnesota Power for the duration of their contracts. The rates and corresponding revenue associated with capacity and energy provided under these contracts are subject to change through the same regulatory process governing all retail electric rates. (See Regulatory Matters – Electric Rates)

ALLETE 2008 Form 10-K

REGULATED OPERATIONS (Continued)

Large Power Customers (Continued)

Minnesota Power, as permitted by the MPUC, requires its taconite-producing Large Power Customers to pay weekly for electric usage based on monthly energy usage estimates. The customers receive estimated bills based on Minnesota Power's prediction of the customer's energy usage, forecasted energy prices and fuel clause adjustment estimates. Minnesota Power's five taconite-producing Large Power Customers have generally predictable energy usage on a week-to-week basis, which makes the variance between the estimated usage and actual usage small.

Contract Status for Minnesota Power Large Power Customers

As of February 1, 2009

Customer	Industry	Location	Ownership	Earliest Termination Date
Hibbing Taconite Co. (a)	Taconite	Hibbing, MN	62.3% ArcelorMittal USA Inc. 23% Cliffs Natural Resources Inc. 14.7% United States Steel Corporation	December 31, 2015
ArcelorMittal USA – Minorca Mine (b)	Taconite	Virginia, MN	ArcelorMittal USA Inc.	February 28, 2013
United States Steel Corporation (USS – Minnesota Ore) (c)	Taconite	Mt. Iron, MN and Keewatin, MN	United States Steel Corporation	October 31, 2013
United Taconite LLC (a)	Taconite	Eveleth, MN	Cliffs Natural Resources Inc.	December 31, 2015
UPM, Blandin Paper Mill (b)	Paper	Grand Rapids, MN	UPM-Kymmene Corporation	February 28, 2013
Boise White Paper, LLC (d)	Paper	International Falls, MN	Boise Paper Holdings, LLC	December 31, 2013
Sappi Cloquet LLC (b)	Paper and Pulp	Cloquet, MN	Sappi Limited	February 28, 2013
NewPage Corporation – Duluth Mills	Paper and Pulp	Duluth, MN	NewPage Corporation	August 31, 2013
USG Interiors, Inc. (e)	Manufacturer	Cloquet, MN	USG Corporation	December 31, 2009
Enbridge Energy Company, Limited Partnership (e)	Pipeline	Deer River, MN Floodwood, MN	Enbridge Energy Company, Limited Partnership	June 30, 2009
Minnesota Pipeline Company (e)	Pipeline	Staples, MN Little Falls, MN Park Rapids, MN	60% Koch Pipeline Co. L.P. 40% Marathon Ashland Petroleum LLC	April 7, 2009

(a) Contract extensions at Hibbing Taconite Co. and United Taconite LLC are pending final approval from the MPUC.

(b) The contract will terminate four years from the date of written notice from either Minnesota Power or the customer. No notice of contract cancellation has been given by either party. Thus, the earliest date of cancellation

is February 28, 2013.

- (c) United States Steel Corporation includes the Minntac Plant in Mountain Iron, MN and the Keewatin Taconite Plant in Keewatin, MN.
- (d) A contract amendment has been filed with the MPUC which provides for an extension of the agreement through December 31, 2013.
- (e) Contracts with USG Interiors, Inc., Minnesota Pipeline Company, and Enbridge Energy Company are all in cancellation periods effective on or before December 31, 2009; new contracts are expected to be agreed upon prior to expiration.

In March 2008, Minnesota Power signed a new contract with Northshore Mining Company to meet additional load requirements. The contract was approved by the MPUC and runs through at least June 30, 2011.

In September 2008, Cliffs Natural Resources Inc. (Cliffs) and Minnesota Power signed new contracts for service to Hibbing Taconite Co. and United Taconite LLC. These electric service agreements, which are pending final MPUC approval, extend the existing contract terms out to at least December 31, 2015.

ALLETE 2008 Form 10-K

REGULATED OPERATIONS (Continued)

Residential and Commercial Customers. In 2008, our residential and commercial customers represented 21 percent of total regulated utility kilowatt-hour sales. Minnesota Power provides regulated utility electric service in northeastern Minnesota to approximately 142,000 residential and commercial customers. SWL&P provides regulated electric service, natural gas and water service in northwestern Wisconsin to 15,000 electric customers, 12,000 natural gas customers and 10,000 water customers.

Municipal Customers. In 2008, our municipal customers represented 8 percent of total regulated utility kilowatt-hour sales. Our municipal customers consist of 16 municipalities in Minnesota and 1 private utility in Wisconsin. The FERC has jurisdiction over our wholesale electric service, tariff rates, and operations. In 2008 Minnesota Power entered into new contracts with all of our municipal customers with the exception of one small customer whose contract is now in the cancellation period. The new contracts transition each customer to formula based rates, which means rates can be adjusted annually based on changes in costs. The new agreement with the private utility in Wisconsin is subject to PSCW approval. In November 2008, we filed a request with the FERC to implement the formula based rate provision in the new contracts. We anticipate final resolution and implementation of new rates in the first quarter of 2009.

Other Power Suppliers. The Company also enters into off system sales with Other Power Suppliers. These sales are dependent upon the availability of generation and are sold at market based prices into the MISO market on a daily basis or through bilateral agreements of various durations.

Approximately 200 MWs of capacity and energy from our Taconite Harbor facility in northern Minnesota has been sold through two sales contracts totaling 175 MWs (201 MWs including a 15 percent reserve), which were effective May 1, 2005, and expire on April 30, 2010. Both contracts contain fixed monthly capacity charges and fixed minimum energy charges. One contract provides for an annual escalator to the energy charge based on increases in our cost of coal, subject to a small minimum annual escalation. The other contract provides that the energy charge will be the greater of the fixed minimum charge or an annual amount based on the variable production cost of a combined-cycle, natural gas unit. Our exposure in the event of a full or partial outage at our Taconite Harbor facility is significantly limited under both contracts. When the buyer is notified at least two months prior to an outage, there is no liability. Outages with less than two months notice are subject to an annual duration limitation typical of this type of contract. These contracts qualify for the normal purchase normal sale exception under SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" and are not required to be recorded at fair value.

For 2009, we have sold up to 225 MWs per month to Other Power Suppliers to mitigate the demand reduction expected from our taconite customers; these contracts expire at various times during 2009.

Power Supply

In order to meet our customer's electric requirements, we utilize a mix of Company generation and purchased power. The Company's generation is primarily coal fired, but also includes approximately 112 MWs of hydro generation from nine hydro stations in Minnesota and 25 MWs of wind generation. Purchased power is made up of long term power purchase agreements and market purchases. The following table reflects the Company's generating capabilities and total electrical requirements as of December 31, 2008. Minnesota Power had an annual net peak load of 1,582 MWs on January 18, 2008.

REGULATED OPERATIONS (Continued)

Power Supply (Continued)

Regulated Utility Power Supply	Unit No.	Year Installed	Net	For the Year Ended	
			Winter Capability MW	December 31, 2008 Electric Requirements MWh	%
Coal-Fired					
Boswell Energy Center in Cohasset, MN	1	1958	69		
	2	1960	69		
	3	1973	350		
	4	1980	429		
			917	6,365,305	48.5%
Laskin Energy Center in Hoyt Lakes, MN	1	1953	55		
	2	1953	55		
			110	659,439	5.0
Taconite Harbor Energy Center in Taconite Harbor, MN	1	1957	73		
	2	1957	73		
	3	1967	74		
			220	1,473,239	11.2
Total Coal			1,247	8,497,983	64.7
Steam – Purchased					
Hibbard Energy Center in Duluth, MN	3 & 4	1949, 1951	45	61,635	0.5
Hydro					
Group consisting of nine stations in MN	Various		112	487,930	3.7
Wind					
Taconite Ridge (a)	1	2008	4	18,587	0.2
Total Company Generation			1,408	9,066,135	69.1
Long Term Purchased Power					
Square Butte burns lignite coal near Center, ND				1,943,949	14.8
Wind – Oliver County, ND				366,945	2.8
Hydro – Manitoba Hydro				390,680	3.0
Total Long Term Purchased Power				2,701,574	20.6
Other Purchased Power(b)				1,357,023	10.3
Total Purchased Power				4,058,597	30.9
Total			1,408	13,124,732	100.0%

(a) The nameplate capacity of Taconite Ridge is 25 MWs. The capacity reflected in the table is actual accredited capacity of the facility. Accredited capacity is the amount of net generating capability associated with the facility for which capacity credit may be obtained using limited historical data. As more data is collected, actual accredited capacity may increase.

(b) Includes short term market purchases in the MISO market and from Other Power Suppliers.

Fuel. Minnesota Power purchases low-sulfur, sub-bituminous coal from the Powder River Basin coal region located in Montana and Wyoming. Coal consumption in 2008 for electric generation at Minnesota Power's coal-fired generating stations was approximately 5.2 million tons. As of December 31, 2008, Minnesota Power had a coal inventory of about 631,000 tons. Minnesota Power's primary coal supply agreements have expiration dates that are staggered from

the end of 2009 through 2011. Under these agreements, Minnesota Power has the tonnage flexibility to procure 70 percent to 100 percent of its total coal requirements. In 2009, Minnesota Power expects to obtain coal under these coal supply agreements and in the spot market. This diversity in coal supply options allows Minnesota Power to manage its coal market price and supply risk and to take advantage of favorable spot market prices. Minnesota Power continues to explore future coal supply options. We believe that adequate supplies of low-sulfur, sub-bituminous coal will continue to be available.

In 2001, Minnesota Power and Burlington Northern Santa Fe Railway Company (BNSF) entered into a long-term agreement under which BNSF transports all of Minnesota Power's coal by unit train from the Powder River Basin directly to Minnesota Power's generating facilities or to designated interconnection points. Minnesota Power also has agreements with an affiliate of the Canadian National Railway and with Midwest Energy Resources Company to transport coal from BNSF interconnection points to certain Minnesota Power facilities.

ALLETE 2008 Form 10-K

REGULATED OPERATIONS (Continued)

Fuel (Continued)

On January 24, 2008, we received a letter from BNSF alleging that the Company defaulted on a material obligation under the Company's Coal Transportation Agreement (CTA). In the notice, BNSF claimed the Company underpaid approximately \$1.6 million for coal transportation services in 2006 and that failure to pay such amount plus interest may result in BNSF's termination of the CTA. We believe we do not owe the amount claimed. On April 1, 2008, to ensure that BNSF did not attempt to terminate the CTA, we paid under protest the full amount claimed by BNSF and filed a demand for arbitration of the issue. On April 22, 2008, BNSF filed a counterclaim in the arbitration disputing our position that we are entitled to a refund from BNSF of \$1.5 million plus interest for amounts that we overpaid for 2007 deliveries. The arbitration is proceeding in connection with the claim regarding 2006 payments and the counterclaim regarding 2007 payments, and we are unable to predict the outcome at this time. The delivered costs of fuel for the Company's generation are recoverable from Minnesota Power's utility customers through the fuel adjustment clause.

Coal Delivered to Minnesota Power			
Year Ended December 31	2008	2007	2006
Average Price per Ton	\$22.73	\$21.78	\$20.19
Average Price per MBtu	\$1.25	\$1.20	\$1.10

Long Term Purchased Power. Minnesota Power has contracts to purchase capacity and energy from various entities. The largest contract is with Square Butte. Under an agreement with Square Butte, expiring at the end of 2026, Minnesota Power is currently entitled to approximately 50 percent of the output of a 455-MW coal-fired generating unit located near Center, North Dakota. (See Note 8. Commitments, Guarantees, and Contingencies.) The Square Butte generating unit operated by Minnkota Power burns North Dakota lignite coal supplied by BNI Coal in accordance with the terms of a contract that extends through 2026. Square Butte's cost of lignite burned in 2008 was approximately \$0.93 per MBtu. The lignite that has been dedicated to Square Butte by BNI Coal is located on lands essentially all of which are under private control and presently leased by BNI Coal. This lignite supply is sufficient to provide fuel for the anticipated useful life of the generating unit.

We have two wind power purchase agreements with an affiliate of NextEra Energy to purchase the output from two wind facilities, Oliver Wind I and II located near Center, North Dakota. We began purchasing the output from Oliver Wind I, a 50-MW facility, in December 2006 and the output from Oliver Wind II, a 48-MW facility in November 2007. Each agreement is for 25 years and provides for the purchase of all output from the facilities.

We currently have a 50 MW power purchase agreement with Manitoba Hydro that expires in April 2009. We have entered into an additional 50 MW power purchase agreement with Manitoba Hydro that begins May 2009 and runs through April 2015.

Transmission and Distribution

We have electric transmission and distribution lines of 500 kV (8 miles), 230 kV (605 miles), 161 kV (43 miles), 138 kV (126 miles), 115 kV (1,224 miles) and less than 115 kV (6,215 miles). We own and operate 165 substations with a total capacity of 10,179 megavoltamperes. Some of our transmission and distribution lines interconnect with other utilities.

Investment in ATC

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Our wholly owned subsidiary, Rainy River Energy owns approximately 8 percent of ATC, a Wisconsin-based utility that owns and maintains electric transmission assets in parts of Wisconsin, Michigan, Minnesota and Illinois. ATC provides transmission service under rates regulated by the FERC that are set in accordance with the FERC's policy of establishing the independent operation and ownership of, and investment in, transmission facilities. We account for our investment in ATC under the equity method of accounting, pursuant to EITF 03-16, "Accounting for Investments in Limited Liability Companies." As of December 31, 2008, our equity investment balance in ATC was \$76.9 million (\$65.7 million at December 31, 2007).

Properties

We own office and service buildings, an energy control center, repair shops, lease offices, and storerooms in various localities. All of our electric plants are subject to mortgages, which collateralize the outstanding first mortgage bonds of Minnesota Power and SWL&P. Generally, we hold fee interest in our real properties subject only to the lien of the mortgages. Most of our electric lines are located on land not owned in fee, but are covered by appropriate easement rights or by necessary permits from governmental authorities. WPPI Energy owns 20 percent of Boswell Unit 4. WPPI Energy has the right to use our transmission line facilities to transport its share of Boswell generation. (See Note 4. Jointly-Owned Electric Facility.)

ALLETE 2008 Form 10-K

REGULATED OPERATIONS (Continued)

Regulatory Matters

We are subject to the jurisdiction of various regulatory authorities. The MPUC has regulatory authority over Minnesota Power's service area in Minnesota, retail rates, retail services, issuance of securities and other matters. The FERC has jurisdiction over the licensing of hydroelectric projects, the establishment of rates and charges for the sale of electricity for resale and transmission of electricity in interstate commerce, certain accounting and record-keeping practices and ATC. The PSCW has regulatory authority over SWL&P's retail sales of electricity, natural gas, water, issuances of securities, and other matters. The MPUC, FERC, and PSCW had regulatory authority over 62 percent, 10 percent, and 9 percent, respectively, of our 2008 consolidated operating revenue.

Electric Rates. Minnesota Power designs its electric service rates based on cost of service studies under which allocations are made to the various classes of customers. Nearly all retail sales include billing adjustment clauses, which adjust electric service rates for changes in the cost of fuel and purchased energy, recovery of current and deferred conservation improvement program expenditures and recovery of certain environmental and renewable expenditures.

Information published by the Edison Electric Institute (Typical Bills and Average Rates Report – Winter 2008 and Rankings – July 1, 2008) ranked Minnesota Power as having the ninth lowest average retail rates out of 175 investor-owned utilities in the United States. According to this report, we had the lowest rates in Minnesota and in the region consisting of Iowa, Kansas, Minnesota, Missouri, North Dakota, South Dakota and Wisconsin.

Minnesota Power requires that all large industrial and commercial customers under contract specify the date when power is first required. Thereafter, the customer is generally billed monthly for at least the minimum power for which they contracted. These conditions are part of all contracts covering power to be supplied to new large industrial and commercial customers and to current customers as their contracts expire or are amended. All rates and other contract terms are subject to approval by appropriate regulatory authorities.

Minnesota Public Utilities Commission. On May 2, 2008, Minnesota Power filed a rate increase request with the MPUC seeking an average rate increase of 8.5 percent for retail customers. The rate filing seeks a return on equity of 11.15 percent, and a capital structure consisting of 54.8 percent equity and 45.2 percent debt. On an annualized basis, the requested rate increase would generate approximately \$40 million in additional revenue. Interim rates were effective on August 1, 2008, and resulted in an increase for retail customers of approximately \$36 million, or 7.5 percent, on an annualized basis, subject to refund pending the final rate order. Incremental revenue in 2008 from the interim retail rate increase was approximately \$13 million. The transition to a new base cost of fuel coincident with interim rates resulted in the non-recovery through the fuel adjustment clause of approximately \$19 million of fuel and purchased power costs incurred in 2008. We have entered into a stipulation and settlement agreement that would allow recovery of the \$19 million in 2009 and which addresses specific concerns identified by interveners in the rate case; the stipulation and settlement agreement is subject to MPUC approval. The final rate order is expected in the second quarter of 2009. We cannot predict the final level of rates that may be approved by the MPUC. Prior to the May 2008 retail rate request Minnesota Power's rates were based on a 1994 MPUC retail rate order that allowed for an 11.6 percent return on equity.

Integrated Resource Plan. In October 2007, Minnesota Power filed its Integrated Resource Plan (IRP), a comprehensive estimate of future capacity needs within the Minnesota Power service territory. In October 2008, the MPUC issued an order approving our request to re-file the IRP by October 1, 2009 in order to incorporate the North Dakota wind project and otherwise update our load forecasting and modeling in the IRP. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Outlook for additional information on the

North Dakota wind project.)

Minnesota Power plans to meet expected loads through approximately 2020 by adding a significant amount of renewable generation and some supporting peaking generation. We plan to add 300 to 500 megawatts of carbon-minimizing renewable energy to our generation mix. Besides the additional generation from renewable sources, Minnesota Power anticipates future supply will come from a combination of sources, including:

- “As-needed” peaking and intermediate generation facilities;
- Expiration of wholesale contracts presently in place;
- Short-term market purchases;
- Improved efficiency of existing generation and power delivery assets; and
- Expanded conservation and demand-side management initiatives.

We do not anticipate the need for new base load system generation within the Minnesota Power service territory through approximately 2020, and we project a one percent average annual growth in electric usage from our existing customers over that time frame.

ALLETE 2008 Form 10-K

REGULATED OPERATIONS (Continued)

Regulatory Matters (Continued)

AREA and Boswell Unit 3 Emission Reduction Plans. In May 2006, the MPUC authorized current cost recovery of expenditures to reduce emissions of SO₂, NO_X, and mercury emissions at Taconite Harbor and Laskin under the AREA Plan. The AREA Plan has significantly reduced emissions from Taconite Harbor and Laskin, while maintaining a reliable and reasonably-priced energy supply to meet the needs of our customers. Environmental retrofits at Laskin and Taconite Harbor Units 1 and 2 are complete and in service. The environmental regulatory requirements for Taconite Harbor Unit 3 are pending finalization of the Minnesota Regional Haze implementation plan by the MPCA. We are expecting to retrofit Taconite Harbor Unit 3 by 2013 and are evaluating compliance requirements and cost recovery options for this final unit.

We are making emission reduction investments at our Boswell Unit 3 generating unit. The investments in pollution control equipment will reduce particulates, SO₂, NO_X, and mercury emissions to meet future federal and state requirements. The MPUC has authorized a cash return on construction work in progress during the construction phase in lieu of AFUDC-Equity and allows for a return on investment and current cost recovery of incremental operations and maintenance expenses once the new equipment is installed and the unit is placed back in service in late 2009. We began cost recovery on January 1, 2008. In September 2008, we filed a petition with the MPUC to approve the Boswell Unit 3 rate adjustment for 2009. If approved, new rates would allow cost recovery relating to additional investments planned for 2009.

Boswell NO_X Reduction Plan. In September 2008, we submitted to the MPCA and MPUC a \$92 million environmental initiative proposing cost recovery for NO_X emission reductions from Boswell Units 1, 2, and 4. If approved by the MPUC, the Boswell NO_X Reduction Plan is expected to significantly reduce NO_X emissions from these units. In conjunction with the NO_X reduction Plan, we plan to install an efficiency upgrade to the existing turbine/generator at Boswell Unit 4 adding approximately 60 MWs of total output with no additional emissions. A second filing requesting cost recovery for the plan will be submitted to the MPUC in the first quarter of 2009.

Conservation Improvement Program (CIP). Minnesota requires electric utilities to spend a minimum of 1.5 percent of gross operating revenues from service provided in the state on energy CIPs each year. These investments are recovered from retail customers through a billing adjustment and amounts included in retail base rates. The MPUC allows utilities to accumulate, in a deferred account for future cost recovery, all CIP expenditures, as well as a carrying charge on the deferred account balance. Minnesota's Next Generation Energy Act of 2007 introduced, in addition to minimum spending requirements, an energy-saving goal of 1.5 percent of gross annual retail electric energy sales by 2010. In May 2007, an abbreviated filing was submitted and subsequently approved by the MPUC, allowing the continuation of Minnesota Power's 2006-2007 CIP biennial and related goals for one additional year, through 2008. For future program years, Minnesota Power will build upon current successful CIPs in an effort to meet the newly established 1.5 percent energy-saving goal. Minnesota Power's CIP investment goal was \$3.7 million for 2008 (\$3.2 million for 2007 and 2006), with actual spending of \$4.8 million in 2008 (\$3.9 million in 2007; \$3.8 million in 2006).

Federal Energy Regulatory Commission. The FERC has jurisdiction over our wholesale electric services and operations. Minnesota Power's hydroelectric facilities, which are located in Minnesota, are also licensed by the FERC.

On February 8, 2008, the FERC approved Minnesota Power's wholesale tariff rate increase effective March 1, 2008. Minnesota Power's wholesale customers consist of 16 municipalities in Minnesota and 1 private utility in Wisconsin. The FERC authorized an average 10.0 percent increase for wholesale municipal customers, and an overall return on equity of 11.25 percent. Incremental revenue in 2008 from the FERC authorized wholesale rate increase was approximately \$6 million.

Public Service Commission of Wisconsin. SWL&P's current retail rates are based on a December 2008 PSCW retail rate order that became effective January 1, 2009, and allows for an 11.1 percent return on common equity. The new rates reflected a 3.5 percent average increase in retail utility rates for SWL&P customers (a 13.4 percent increase in water rates, a 4.7 percent increase in electric rates, and a 0.6 percent decrease in natural gas rates). On an annualized basis, the rate increase will generate approximately \$3 million in additional revenue.

Regional Organizations

Midwest Independent Transmission System Operator, Inc. Minnesota Power and SWL&P are members of MISO, a regional transmission organization. Minnesota Power and SWL&P retain ownership of their respective transmission assets and control area functions, but their transmission network is under the regional operational control of MISO, and they take and provide transmission service under the MISO open access transmission tariff. MISO continues its efforts to standardize rates, terms, and conditions of transmission service over its broad region, encompassing all or parts of 15 states and one Canadian province, and over 100,000 MWs of generating capacity.

In January 2009, MISO launched the new Ancillary Services Market (ASM) aimed at establishing a market for energy and operating reserves. In May 2008, in preparation of the new market, Minnesota Power and the other investor-owned utilities in Minnesota prepared a joint filing seeking MPUC approval for the authority to account for costs and revenues that have been instituted by the ASM market. The MPUC held a discussion-only hearing on the joint filing in December 2008, and has indicated it will likely bring the matter back before the MPUC in the first quarter of 2009.

ALLETE 2008 Form 10-K

REGULATED OPERATIONS (Continued)

Regional Organizations (Continued)

Mid-Continent Area Power Pool (MAPP). Minnesota Power also participates in MAPP, a power pool operating in parts of eight states in the Upper Midwest and in two Canadian provinces. MAPP functions include a regional transmission committee and a generation reserve sharing pool.

Minnesota Legislation

Renewable Energy. In February 2007, Minnesota enacted a law requiring Minnesota Power to generate or procure 25 percent of our energy from renewable energy sources by 2025. The law also requires Minnesota Power to meet interim milestones of 12 percent by 2012, 17 percent by 2016, and 20 percent by 2020. The law allows the MPUC to modify or delay a standard obligation if implementation will cause significant ratepayer cost or technical reliability issues. If a utility is not in compliance with a standard, the MPUC may order the utility to construct facilities, purchase renewable energy or purchase renewable energy credits. Minnesota Power was developing and making renewable supply additions as part of its generation planning strategy prior to the enactment of this law and this activity continues.

Greenhouse Gas Reduction. In 2007, Minnesota passed legislation establishing non-binding targets for carbon dioxide reductions. This legislation establishes a goal of reducing statewide GHG emissions across all sectors to a level at least 15 percent below 2005 levels by 2015, at least 30 percent below 2005 levels by 2025, and at least 80 percent below 2005 levels by 2050. Minnesota is also participating in the Midwestern Greenhouse Gas Reduction Accord, a regional effort to develop a multi-state approach to GHG emission reductions.

We cannot predict the nature or timing of any additional GHG legislation or regulation. Although we are unable to predict the compliance costs we might incur, the costs could have a material impact on our financial results.

Competition

In August 2005, the Energy Policy Act of 2005 (EPAAct 2005) was signed into law, which and enacted PUHCA 2005. PUHCA 2005 gives FERC certain authority over books and records of public utility holding companies and their affiliates. It also addresses FERC review and authorization of the allocation of costs for non-power goods, or administrative or management services when requested by a holding company system or state commission. In addition, EPAAct 2005 directs the FERC to issue certain rules addressing electricity reliability, investment in energy infrastructure, fuel diversity for electric generation, promotion of energy efficiency and wise energy use.

We believe the overall impact of the EPAAct 2005 on the electric utility industry has been positive and are continuing to evaluate the effects on our business as this legislation is being implemented. This federal legislation is designed to bring more certainty to energy markets in which ALLETE participates, as well as to provide investment incentives for energy efficiency, energy infrastructure (such as electric transmission lines) and energy production. The FERC has the responsibility of implementing numerous new standards as a result of the promulgation of the EPAAct 2005. To date the FERC's regulatory efforts under the EPAAct 2005 appear to be generally positive for the utility industry. We cannot predict the timing or substance of any future legislation or regulation.

Franchises

Minnesota Power holds franchises to construct and maintain an electric distribution and transmission system in 93 cities and towns located within its electric service territory. SWL&P holds similar franchises for electric, natural gas and/or water systems in 15 cities and towns within its service territory. The remaining cities and towns served by us

do not require a franchise to operate within their boundaries. Our exclusive service territories are established by state regulatory agencies.

ALLETE 2008 Form 10-K

INVESTMENTS AND OTHER

Investments and Other is comprised primarily of BNI Coal, our coal mining operations in North Dakota, and ALLETE Properties, our Florida real estate business. This segment also includes emerging technology investments (\$7.4 million at December 31, 2008), a small amount of non-rate base generation, approximately 7,000 acres of land for sale in Minnesota, and earnings on cash and short-term investments.

BNI Coal

BNI Coal operates a lignite mine in North Dakota. BNI Coal is a low-cost supplier of lignite in North Dakota, producing about 4 million tons annually. Two electric generating cooperatives, Minnkota Power and Square Butte, presently consume virtually all of BNI Coal's production of lignite under cost-plus coal supply agreements extending through 2026. (See Item 1. Business – Fuel and Note 8. Commitments, Guarantees and Contingencies.) The mining process disturbs and reclaims between 200 and 250 acres per year. Laws require that the reclaimed land be at least as productive as it was prior to mining. The average cost to reclaim one acre of land is approximately \$35,000, however, depending on conditions, it could be significantly higher. Reclamation costs are included in the cost of coal passed through to customers. With lignite reserves of an estimated 600 million tons, BNI Coal has ample capacity to expand production.

ALLETE Properties

ALLETE Properties is our real estate business that has operated in Florida since 1991. Our current strategy is to complete and maintain key entitlements and infrastructure improvements which enhance values without requiring significant additional investment, and position the current property portfolio for a maximization of value and cash flow when market conditions improve.

Our two major development projects include Town Center and Palm Coast Park. A third proposed development project, Ormond Crossings, is in the permitting and planning stage. Development activities involve mainly zoning, permitting, platting, and master infrastructure construction. Development costs are financed through a combination of community development district bonds, bank loans, and internally-generated funds.

Town Center. Town Center, which is located in the city of Palm Coast, is a mixed-use development with a neo-traditional downtown core area. Construction of the major infrastructure improvements at Town Center was substantially complete at the end of 2006. At build-out, Town Center is expected to include approximately 3,200 residential units and 3.8 million square feet of various types of non-residential space. Sites have also been set aside for a new city hall, a community center, an art and entertainment center, and other public uses. Market conditions will determine how quickly Town Center builds out.

Palm Coast Park. Palm Coast Park, which is located in the city of Palm Coast, is a 4,700-acre mixed-use development. Major infrastructure construction at Palm Coast Park was substantially complete at the end of 2007. At build-out, Palm Coast Park is expected to include approximately 4,000 residential units, 3.2 million square feet of various types of non-residential space and certain public facilities. Market conditions will determine how quickly Palm Coast Park builds out.

Ormond Crossings. Ormond Crossings is an approximately 6,000-acre mixed-use development that is located in both the city of Ormond Beach in Volusia County and unincorporated Flagler County. Planning, engineering design, and permitting of the master infrastructure are ongoing. We estimate the first two phases of Ormond Crossings will include 2,500–3,200 residential units and 2.5–3.5 million square feet of various types of non-residential space. Ormond Crossings will also include approximately 2,000 acres of a regionally significant wetlands mitigation bank that was

permitted by the St. Johns River Water Management District in 2008 and is expected to be permitted by the U.S. Army Corps of Engineers in 2009. Wetland mitigation credits will be used at Ormond Crossings and will be available-for-sale to other developers. Market conditions will determine when and if Ormond Crossings will be built out. We do not expect any significant activity in 2009.

See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for more information on ALLETE Properties' land holdings.

Seller Financing. ALLETE Properties sometimes provides seller financing. At December 31, 2008, outstanding finance receivables were \$13.6 million, with maturities up to 4 years. These finance receivables accrue interest at market-based rates and are collateralized by the financed properties.

Regulation. A substantial portion of our development properties in Florida are subject to federal, state and local regulations, and restrictions that may impose significant costs or limitations on our ability to develop the properties. Much of our property is vacant land and some is located in areas where development may affect the natural habitats of various protected wildlife species or in sensitive environmental areas such as wetlands.

ALLETE 2008 Form 10-K

INVESTMENTS AND OTHER (Continued)

Non-Rate Base Generation

Non-Rate base generation consists of approximately 50 MWs of generation. In 2008, we sold 0.2 million MWh of non-rate base generation (0.2 million in 2007 and 2006).

Non-Rate Base Power Supply	Unit No.	Year Installed	Year Acquired	Net Capability MW
Steam				
Wood-Fired (a)				
Cloquet Energy Center in Cloquet, MN	5	2001	2001	23
Rapids Energy Center (b) in Grand Rapids, MN	6 & 7	1969, 1980	2000	29
Hydro				
Conventional Run-of-River				
Rapids Energy Center (b) in Grand Rapids, MN	4 & 5	1917	2000	1

(a) Supplemented by coal.

(b) The net generation is primarily dedicated to the needs of one customer.

Other

Minnesota Land. We have about 7,000 acres of land available-for-sale in Minnesota. We acquired the land in 2001 when we purchased Taconite Harbor.

Emerging Technology Investments. The majority of our emerging technology investments are minority investments in venture capital funds. We account for our investment in venture capital funds under the equity method of accounting. The total carrying value of our emerging technology portfolio was \$7.4 million at December 31, 2008. (See Note 6. Investments.) Our remaining commitment of \$0.7 million at December 31, 2008 may be invested in 2009. We do not have plans to make any additional investments beyond this commitment.

Environmental Matters

Our businesses are subject to regulation of environmental matters by various federal, state and local authorities. We consider our businesses to be in substantial compliance with currently applicable environmental regulations and believe all necessary permits to conduct such operations have been obtained. Due to future stricter environmental requirements through legislation and/or rulemaking, we anticipate that potential expenditures for environmental matters will be material and will require significant capital investments. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Capital Requirements.)

We review environmental matters for disclosure on a quarterly basis. Accruals for environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, based on current law and existing technologies. These accruals are adjusted periodically as assessment and remediation efforts progress, or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the balance sheet at undiscounted amounts and exclude claims for recoveries from insurance

or other third parties. Costs related to environmental contamination treatment and cleanup are charged to expense unless recoverable in rates from customers.

Air. Clean Air Act. The federal Clean Air Act Amendments of 1990 (Clean Air Act) established the acid rain program which created emission allowances for SO₂ and system wide averaging NO_X limits. Minnesota Power's generating facilities mainly burn low-sulfur western sub-bituminous coal. Square Butte, located in North Dakota, burns lignite coal. All of these facilities are equipped with pollution control equipment such as scrubbers, bag houses, or electrostatic precipitators. Minnesota Power's generating facilities are currently in compliance with permitted emission requirements.

ALLETE 2008 Form 10-K

Environmental Matters (Continued)

Air (Continued)

New Source Review. On August 8, 2008, Minnesota Power received a Notice of Violation (NOV) from the United States EPA asserting violations of the New Source Review (NSR) requirements of the Clean Air Act at Boswell Units 1-4 and Laskin Unit 2. The NOV also asserts that the Boswell Unit 4 Title V permit was violated. The NOV asserts that seven projects undertaken at these coal-fired plants between the years 1981 and 2000 should have been reviewed under the NSR requirements. Minnesota Power believes the projects were in full compliance with the Clean Air Act, NSR requirements and applicable permits.

The EPA has been conducting a nationwide enforcement initiative since 1999 relating to NSR requirements. In 2000, 2001, and 2002 Minnesota Power received requests from the EPA pursuant to Section 114(a) of the Clean Air Act seeking information regarding capital expenditures with respect to Boswell and Laskin. Minnesota Power responded to these requests; however, we had no further communications from the EPA regarding the information provided until receipt of the NOV.

We are engaged in discussions with the EPA regarding resolution of these matters, but we are unable to predict the outcome of these discussions. Since 2006, Minnesota Power has significantly reduced, and continues to reduce, emissions at Boswell and Laskin. The resolution could result in civil penalties and the installation of control technology, some of which is already planned or completed for other regulatory requirements. Any costs of installing pollution control technology would likely be eligible for recovery in rates over time subject to MPUC and FERC approval in a rate proceeding. We are unable to predict the ultimate financi