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ALLETE INC
Form 10-K
February 22, 2016

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, 2015
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number 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 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 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 whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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

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incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer x 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 Exchange Act).

Yes “ No x

The aggregate market value of voting stock held by nonaffiliates on June 30, 2015, was \$2,256,186,129.

As of February 1, 2016, there were 49,111,849 shares of ALLETE Common Stock, without par value, outstanding.

Documents Incorporated By Reference

Portions of the Proxy Statement for the 2016 Annual Meeting of Shareholders are incorporated by reference in Part III.

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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
AFUDC	Allowance for Funds Used During Construction - the cost of both debt and equity funds used to finance utility plant additions during construction periods
ALLETE	ALLETE, Inc.
ALLETE Clean Energy	ALLETE Clean Energy, Inc. and its subsidiaries
ALLETE Properties	ALLETE Properties, LLC and its subsidiaries
ALLETE Transmission Holdings	ALLETE Transmission Holdings (formerly Rainy River Energy Corporation - Wisconsin)
ArcelorMittal	ArcelorMittal USA, Inc.
ATC	American Transmission Company LLC
Basin	Basin Electric Power Cooperative
Bison	Bison Wind Energy Center
BNI Energy	BNI Coal, Ltd. d/b/a BNI Energy
Boswell	Boswell Energy Center
CO ₂	Carbon Dioxide
Company	ALLETE, Inc. and its subsidiaries
CSAPR	Cross-State Air Pollution Rule
DC	Direct Current
EIS	Environmental Impact Statement
Enbridge	Enbridge, Inc.
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
GAAP	Accounting Principles Generally Accepted in the United States
GHG	Greenhouse Gases
GNTL	Great Northern Transmission Line
IBEW	International Brotherhood of Electrical Workers
Invest Direct	ALLETE’s Direct Stock Purchase and Dividend Reinvestment Plan
IRP	Integrated Resource Plan
Item ____	Item ____ of this Form 10-K
kV	Kilovolt(s)
kWh	Kilowatt-hour
Laskin	Laskin Energy Center
LIBOR	London Interbank Offered Rate
MACT	Maximum Achievable Control Technology
Magnetation	Magnetation, LLC
Manitoba Hydro	Manitoba Hydro-Electric Board
MATS	Mercury and Air Toxics Standards
MBtu	Million British thermal units

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Definitions (continued)

Abbreviation or Acronym	Term
Mesabi Nugget	Mesabi Nugget Delaware, LLC
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MISO	Midcontinent Independent System Operator, Inc.
Montana-Dakota Utilities	Montana-Dakota Utilities Co., a division of MDU Resources Group, 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)
NAAQS	National Ambient Air Quality Standards
NDPSC	North Dakota Public Service Commission
NERC	North American Electric Reliability Corporation
NOL	Net Operating Loss
Non-residential	Retail and non-retail commercial, office, industrial, warehouse, storage and institutional
NO ₂	Nitrogen Dioxide
NO _x	Nitrogen Oxides
Note ____	Note ____ to the consolidated financial statements in this Form 10-K
NPDES	National Pollutant Discharge Elimination System
NYSE	New York Stock Exchange
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	PolyMet Mining Corp.
PPA	Power Purchase Agreement
PPACA	Patient Protection and Affordable Care Act of 2010
PSCW	Public Service Commission of Wisconsin
RSOP	Retirement Savings and Stock Ownership Plan
SEC	Securities and Exchange Commission
SIP	State Implementation Plan
SO ₂	Sulfur Dioxide
Square Butte	Square Butte Electric Cooperative
Standard & Poor's	Standard & Poor's Ratings Services
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
Taconite Ridge	Taconite Ridge Energy Center
Thomson	Thomson Energy Center
Town Center	Town Center at Palm Coast development project in Florida
Town Center District	Town Center at Palm Coast Community Development District
TransAlta	TransAlta Energy Marketing (U.S.) Inc.
U.S.	United States of America
U.S. Water Services	U.S. Water Services Holding Company and its subsidiaries
USS Corporation	United States Steel Corporation

Forward-Looking Statements

Statements in this report that are not statements of historical facts are 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 can be 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,” “likely,” “will continue,” “could,” “may,” “potential,” “target,” “outlook” or words of 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 providing this cautionary statement to identify important factors that could cause our actual results to differ materially from those indicated in forward-looking statements made by or on behalf of ALLETE in this 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 that could cause our actual results to differ materially from those indicated in the forward-looking statements:

- our ability to successfully implement our strategic objectives;
- global and domestic economic conditions affecting us or our customers;
- changes in and compliance with laws and regulations;
- changes in tax rates or policies or in rates of inflation;
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements;
- weather conditions, natural disasters and pandemic diseases;
- our ability to access capital markets and bank financing;
- changes in interest rates and the performance of the financial markets;
- project delays or changes in project costs;
- changes in operating expenses and capital expenditures and our ability to raise revenues from our customers in regulated rates or sales price increases at our Energy Infrastructure and Related Services businesses;
- the impacts of commodity prices on ALLETE and our customers;
- our ability to attract and retain qualified, skilled and experienced personnel;
- effects of emerging technology;
- war, acts of terrorism and cyber attacks;
- our ability to manage expansion and integrate acquisitions;
- population growth rates and demographic patterns;
- wholesale power market conditions;
- federal and state regulatory and legislative actions that impact regulated utility economics, including our allowed rates of return, capital structure, ability to secure financing, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities and utility infrastructure, recovery of purchased power, capital investments and other expenses, including present or prospective environmental matters;
- effects of competition, including competition for retail and wholesale customers;
- effects of restructuring initiatives in the electric industry;
- the impacts on our Regulated Operations segment of climate change and future regulation to restrict the emissions of greenhouse gases;
 - effects of increased deployment of distributed low-carbon electricity generation resources;
- the impacts of laws and regulations related to renewable and distributed generation;
- pricing, availability and transportation of fuel and other commodities and the ability to recover the costs of such commodities;

our current and potential industrial and municipal customers' ability to execute announced expansion plans; real estate market conditions where our legacy Florida real estate investment is located may not improve; the success of efforts to realize value from, invest in, and develop new opportunities in, our Energy Infrastructure and Related Services businesses; and factors affecting Energy Infrastructure and Related Services businesses, including fluctuations in the volume of customer orders, unanticipated cost increases, changes in legislation and regulations impacting the industries in which the customers served operate, the effects of weather, credit worthiness of customers, ability to obtain materials required to perform services, and changing market conditions.

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Forward Looking Statements (Continued)

Additional disclosures regarding factors that could cause our results or performance to differ from those anticipated by this report are discussed in Item 1A under the heading “Risk Factors” beginning on page 25 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 ALLETE in this Form 10-K and in other reports filed with the SEC that attempt to identify the risks and uncertainties that may affect ALLETE’s business.

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Part I

Item 1. Business

Regulated Operations includes our regulated utilities, Minnesota Power and SWL&P, as well as our investment in ATC, a Wisconsin-based regulated 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 approximately 145,000 retail customers. Minnesota Power also has 16 non-affiliated municipal customers in Minnesota. SWL&P is a Wisconsin utility and a wholesale customer of Minnesota Power. SWL&P provides regulated electric, natural gas and water service in northwestern Wisconsin to approximately 15,000 electric customers, 13,000 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.

ALLETE Clean Energy was established in 2011, and focuses on developing, acquiring and operating clean and renewable energy projects. ALLETE Clean Energy currently owns and operates, in four states, approximately 535 MW of nameplate capacity wind energy generation that are under long-term power sales agreements. In addition, ALLETE Clean Energy constructed a 107 MW wind energy facility for sale to Montana-Dakota Utilities; construction and sale were completed in 2015.

U.S. Water Services is our integrated water management company which was acquired on February 10, 2015.

Corporate and Other is comprised of BNI Energy, our coal mining operations in North Dakota, ALLETE Properties, our legacy Florida real estate investment, other business development and corporate expenditures, unallocated interest expense, a small amount of non-rate base generation, approximately 5,000 acres of land in Minnesota, and earnings on cash and investments.

ALLETE is incorporated under the laws of Minnesota. Our corporate headquarters are in Duluth, Minnesota. Statistical information is presented as of December 31, 2015, 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	2015	2014	2013	
Consolidated Operating Revenue – Millions (a)	\$1,486.4	\$1,136.8	\$1,018.4	
Percentage of Consolidated Operating Revenue				
Regulated Operations	67	% 88	% 91	%
ALLETE Clean Energy (a)(b)	18	% 3	% —	
U.S. Water Services (c)	8	% —	—	
Corporate and Other	7	% 9	% 9	%
	100	% 100	% 100	%

(a) Includes the construction and sale of a wind energy facility by ALLETE Clean Energy to Montana-Dakota Utilities for \$197.7 million in 2015. (See Note 7. Acquisitions.)

(b) Reflects operations acquired in conjunction with the ALLETE Clean Energy wind energy facilities acquisitions. (See Note 7. Acquisitions.)

(c) U.S. Water Services was acquired on February 10, 2015. (See Note 7. Acquisitions.)

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.

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REGULATED OPERATIONS

Electric Sales / Customers

Regulated Utility Kilowatt-hours Sold

Year Ended December 31	2015	%	2014	%	2013	%
Millions						
Retail and Municipal						
Residential	1,113	8	1,204	9	1,177	9
Commercial	1,462	10	1,468	10	1,455	11
Industrial	6,635	46	7,487	54	7,338	55
Municipal	833	6	864	6	999	8
Total Retail and Municipal	10,043	70	11,023	79	10,969	83
Other Power Suppliers	4,310	30	2,904	21	2,278	17
Total Regulated Utility Kilowatt-hours Sold	14,353	100	13,927	100	13,247	100

Industrial Customers. In 2015, industrial customers represented 46 percent of total regulated utility kilowatt-hour sales. Our industrial customers are primarily in the taconite mining, iron concentrate, paper, pulp and secondary wood products, and pipeline industries.

Industrial Customer Kilowatt-hours Sold

Year Ended December 31	2015	%	2014	%	2013	%
Millions						
Taconite/Iron Concentrate	4,000	60	4,880	65	4,851	66
Paper, Pulp and Secondary Wood Products	1,456	22	1,499	20	1,505	21
Pipelines and Other Industrial	1,179	18	1,108	15	982	13
Total Industrial Customer Kilowatt-hours Sold	6,635	100	7,487	100	7,338	100

Eight Minnesota Power taconite and iron concentrate customers produce approximately 77 percent of the iron ore produced in the U.S. according to the U.S. Geological Survey's 2012 Minerals Yearbook published in September 2014. Sales to taconite customers and iron concentrate customers represented 4,000 million kilowatt-hours, or 60 percent, of total industrial customer kilowatt-hour sales in 2015. Taconite, an iron-bearing rock of relatively low iron content, is abundantly available in northern 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. Iron concentrate reclamation facilities also use large quantities of electricity to extract and process iron-bearing tailings left from previous mining operations to produce iron ore concentrate.

Minnesota Power provides electric service to five taconite customers capable of producing up to approximately 41 million tons of taconite pellets annually. Four of these customers are Large Power Customers (see Large Power Customer Contracts). The fifth is Northshore Mining, owned and operated by Cliffs Natural Resources Inc., which self-generates a majority of its power, and is capable of producing approximately 6 million tons of taconite pellets annually. Taconite pellets produced in Minnesota are primarily shipped to North American steel making facilities that are part of the integrated steel industry. Steel produced from these North American facilities is used primarily in the manufacture of automobiles, appliances, pipe and tube products for the gas and oil industry, and in the construction industry. Historically, less than five percent of Minnesota taconite production is exported outside of North America. Minnesota Power also provides electric service to three iron concentrate facilities capable of producing up to approximately 4 million tons of iron concentrate per year. Iron concentrate is used in the production of taconite pellets.

There has been a general historical correlation between U.S. steel production and Minnesota taconite production. The American Iron and Steel Institute (AISI), an association of North American steel producers, reported that U.S. raw steel production operated at approximately 71 percent of capacity in 2015 (77 percent in 2014 and in 2013). Many steel producers reduced production in 2015, citing higher levels of imports and lower prices. Some Minnesota taconite and iron concentrate producers reduced production in 2015 in response to declining U.S. steel production.

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REGULATED OPERATIONS (Continued)
 Industrial Customers (Continued)

The following table reflects Minnesota Power's taconite customers' production levels for the past ten years.

Minnesota Power Taconite Customer Production

Year	Tons (Millions)
2015*	30
2014	39
2013	37
2012	39
2011	39
2010	35
2009	17
2008	39
2007	38
2006	39

Source: Minnesota Department of Revenue 2015 Mining Tax Guide for years 2006 - 2014.

* Preliminary data from the Minnesota Department of Revenue.

Minnesota Power's taconite customers may experience annual variations in production levels due to such factors as economic conditions, short-term demand changes or maintenance outages. We estimate that a one million ton change in Minnesota Power's taconite customers' production would impact our annual earnings per share by approximately \$0.03, net of expected power marketing sales at current prices. Changes in wholesale electric prices or customer contractual demand nominations could impact this estimate. Long-term reductions in taconite production or a permanent shut down of a taconite customer may lead Minnesota Power to file a rate case to recover lost revenue.

In addition to serving the taconite industry, Minnesota Power serves a number of customers in the paper, pulp and secondary wood products industry, which represented 1,456 million kilowatt-hours, or 22 percent, of total industrial customer kilowatt-hour sales in 2015. The four major paper and pulp mills we serve reported operating at, or near, full capacity in 2015. In September 2014, Boise, Inc. (Boise) provided the required one-year written notice of its intent to install additional generation at its International Falls, Minnesota, paper mill which was completed in 2015. Boise's reduction in demand is not expected to have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

Large Power Customer Contracts. Minnesota Power has 9 Large Power Customer contracts, each serving requirements of 10 MW or more of customer load. The customers consist of five taconite producing facilities (two of which are owned by one company and are served under a single contract), two concentrate reclamation facilities (both of which are owned by one company and are served under a single contract), and four paper and pulp mills.

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 term 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. Three of the Large Power Customers have interruptible service which provides a discounted demand rate in exchange 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.

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REGULATED OPERATIONS (Continued)
Large Power Customer Contracts (Continued)

All contracts with Large Power Customers continue past the contract termination date unless the required advance notice of cancellation has been given. The required 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 Item 1. Business – Regulated Operations – Regulatory Matters – Electric Rates.)

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. These customers receive estimated bills based on Minnesota Power's estimate of the customer's energy usage, forecasted energy prices, and fuel clause adjustment estimates. Minnesota Power's four taconite-producing Large Power Customers have generally predictable energy usage on a week-to-week basis, and any differences that occur are trued-up the following month.

Contract Status for Minnesota Power Large Power Customers
As of February 1, 2016

Customer	Industry	Location	Ownership	Earliest Termination Date
ArcelorMittal USA, Inc. – Minorca Mine (a)	Taconite	Virginia, MN	ArcelorMittal S.A. 62.3% ArcelorMittal S.A. 23.0% Cliffs Natural Resources Inc.	December 31, 2025
Hibbing Taconite Co. (b)	Taconite	Hibbing, MN	14.7% USS Corporation	January 31, 2020
United Taconite LLC (b)	Taconite	Eveleth, MN	Cliffs Natural Resources Inc.	January 31, 2020
USS Corporation (USS – Minnesota Ore) (b)(c)	Taconite	Mt. Iron, MN and Keewatin, MN	USS Corporation	January 31, 2020
Boise, Inc.	Paper	International Falls, MN	Packaging Corporation of America	December 31, 2023
UPM, Blandin Paper Mill (b)	Paper	Grand Rapids, MN	UPM-Kymmene Corporation	January 31, 2020
NewPage Corporation (d)	Paper and Pulp	Duluth, MN	Verso Corporation	December 31, 2022
Sappi Cloquet LLC (b)	Paper and Pulp	Cloquet, MN	Sappi Limited	January 31, 2020
Magnetation, LLC (e)	Iron Concentrate	Coleraine, MN and Bovey, MN	50.1% Magnetation, Inc. 49.9% AK Steel Corporation	December 31, 2025

(a) In November 2015, Minnesota Power and ArcelorMittal USA, Inc. signed a new 10-year electric service agreement through December 31, 2025, which was approved by the MPUC in an order dated February 2, 2016.

The contract will terminate four years from the date of written notice from either Minnesota Power or the (b) customer. No notice of contract cancellation has been given by either party. Thus, the earliest date of cancellation is January 31, 2020.

(c) USS Corporation owns both the Minntac Plant in Mountain Iron, MN, and the Keewatin Taconite Plant in Keewatin, MN.

(d) On January 7, 2015, Verso Corporation acquired NewPage Corporation. This acquisition does not impact Minnesota Power's electric service agreement with NewPage Corporation. On January 26, 2016, Verso Corporation announced that it had filed voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code. (See

Item 7. Management's Discussion and Analysis – Outlook – Industrial Customers and Prospective Additional Load.)
On July 24, 2015, Minnesota Power filed a petition with the MPUC for approval of a new electric service agreement (Agreement) for service to both Magnetation's Plant 2 and Plant 4 facilities, with a term through at least (e)December 31, 2025. This Agreement was approved by the MPUC in an order dated February 2, 2016, and is subject to bankruptcy court approval. (See Item 7. Management's Discussion and Analysis – Outlook – Industrial Customers and Prospective Additional Load.)

Residential and Commercial Customers. In 2015, residential and commercial customers represented 18 percent of total regulated utility kilowatt-hour sales. Minnesota Power provides regulated utility electric service in northeastern Minnesota to approximately 144,000 residential and commercial customers. SWL&P provides regulated electric, natural gas and water service in northwestern Wisconsin to approximately 15,000 electric customers, 13,000 natural gas customers and 10,000 water customers.

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REGULATED OPERATIONS (Continued)

Municipal Customers. In 2015, municipal customers represented 6 percent of total regulated utility kilowatt-hour sales. Minnesota Power has 16 non-affiliated municipal customers in Minnesota.

On April 21, 2015, Minnesota Power amended its formula-based wholesale electric sales contract with the Nashwauk Public Utilities Commission, extending the term through June 30, 2028. The electric service agreement with one other municipal customer is effective through June 30, 2019. The rates included in these contracts are set each July 1 based on a cost-based formula methodology, using estimated costs and a rate of return that is equal to Minnesota Power's authorized rate of return for Minnesota retail customers (currently 10.38 percent). The formula-based rate methodology also provides for a yearly true-up calculation for actual costs incurred.

In September 2015, Minnesota Power amended its wholesale electric contracts with 14 municipal customers, extending the contract terms through December 31, 2024. These contracts include fixed capacity charges through 2018; beginning in 2019, the capacity charge will not increase by more than two percent or decrease by more than negative one percent from the previous year's capacity charge and will be determined using a cost-based formula methodology. The base energy charge for each year of the contract term will be set each January 1, subject to monthly adjustment, and is also determined using a cost-based formula methodology.

All of the wholesale contracts include a termination clause requiring a three-year notice to terminate. In January 2016, one of Minnesota Power's munic