ALLETE INC
Form 10-K405
February 08, 2002

Form 10-K

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended DECEMBER 31, 2001

/ / 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
8.05% Cumulative Quarterly Income Preferred Securities of ALLETE Capital I, a subsidiary of ALLETE	New York Stock Exchange

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

None

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 /X/ No / /

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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. /X/

The aggregate market value of voting stock held by nonaffiliates on January 28, 2002 was $2,205,233,476.

As of January 28, 2002 there were 84,060,127 shares of ALLETE Common Stock, without par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2002 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.

ABBREVIATION OR ACRONYM	TERM
ACE	ACE Limited
ADESA	ADESA Corporation
ADESA Canada	ADESA Canada Inc.
ADESA Importation	ADESA Importation Services, Inc.
AFC	Automotive Finance Corporation
ALLETE	ALLETE, Inc. and its subsidiaries
APC	Auto Placement Center
AutoVIN	AutoVIN, Inc.
Blandin Paper	Blandin Paper Company
BNI Coal	BNI Coal, Ltd.
Boswell	Boswell Energy Center
CAG	Canadian Auction Group
Cape Coral Holdings	Cape Coral Holdings, Inc.
Capital Re	Capital Re Corporation
CIP	Conservation Improvement Program(s)
Cleveland-Cliffs	Cleveland-Cliffs Inc.
Company	ALLETE, Inc. and its subsidiaries
ComSearch	ComSearch, Inc.
EBITDAL	Earnings Before Interest, Taxes,

	Depreciation, Amortization and Lease Expense
EndTrust	EndTrust Lease End Services, LLC
Enventis Telecom	Enventis Telecom, Inc.
EPA	Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Florida Water	Florida Water Services Corporation
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
FPSC	Florida Public Service Commission
Great River	Great River Energy
Heater	Heater Utilities, Inc.
Hibbard	M.L. Hibbard Station
Impact Auto	Impact Auto Auctions Ltd. and Suburban Auto Parts Inc., collectively
Invest Direct	ALLETE's Direct Stock Purchase and Dividend Reinvestment Plan
kWh	Kilowatthour(s)
kV	Kilovolt(s)
Laskin	Laskin Energy Center
Lehigh	Lehigh Acquisition Corporation
LTV	LTV Steel Mining Co.
Manheim	Manheim Auctions, Inc.
MAPP	Mid-Continent Area Power Pool
MBtu	Million British thermal units
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MISO	Midwest Independent Transmission System Operator Inc.
MP Telecom	Minnesota Power Telecom, Inc.
MPUC	Minnesota Public Utilities Commission
MW	Megawatt(s)
MWh	Megawatthour(s)
NCUC	North Carolina Utilities Commission
Note___	Note___ to the consolidated financial statements indexed in Item 14(a) of this Form 10-K
NPDES	National Pollutant Discharge Elimination System
PAR	PAR, Inc.
PSCW	Public Service Commission of Wisconsin
Rainy River Energy	Rainy River Energy Corporation
SFAS	Statement of Financial Accounting Standards No.
Split Rock Energy	Split Rock Energy LLC
Square Butte	Square Butte Electric Cooperative
SWL&P	Superior Water, Light and Power Company
WPPI	Wisconsin Public Power, Inc.

SAFE HARBOR STATEMENT

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

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 in forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) made by or on behalf of ALLETE in this Annual Report on Form 10-K, in presentations, in response to questions or otherwise. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "will likely result," "will continue" or similar expressions) are not statements of historical facts and may be forward-looking.

Forward-looking statements involve estimates, assumptions, risks and uncertainties and are qualified in their entirety by reference to, and are accompanied by, the following important factors, which are difficult to predict, contain uncertainties, are beyond our control and may cause actual results or outcomes to differ materially from those contained in forward-looking statements:

- war and acts of terrorism;
- prevailing governmental policies and regulatory actions, including those of the United States Congress, state legislatures, the FERC, the MPUC, the FPSC, the NCUC, the PSCW and various county regulators, about allowed rates of return, financings, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities, recovery of purchased power and capital investments, and present or prospective wholesale and retail competition (including but not limited to transmission costs) as well as general vehicle-related laws, including vehicle brokerage and auction laws;
- unanticipated impacts of restructuring initiatives in the electric industry;
- economic and geographic factors, including political and economic risks;
- changes in and compliance with environmental and safety laws and policies;
- weather conditions;
- population growth rates and demographic patterns;
- the effects of competition, including competition for retail and wholesale customers, as well as suppliers and purchasers of automobiles;
- pricing and transportation of commodities;
- market demand, including structural market changes;
- changes in tax rates or policies or in rates of inflation;
- unanticipated project delays or changes in project costs;
- unanticipated changes in operating expenses and capital expenditures;
- capital market conditions;

- competition for economic expansion or development opportunities;

- our ability to manage expansion and integrate recent acquisitions; and

- legal and administrative proceedings (whether civil or criminal) and settlements that affect the business and profitability of ALLETE.

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.

PART I

ITEM 1. BUSINESS

ALLETE is a diversified company incorporated under the laws of Minnesota since 1906. References in this report to "we" and "our" are to ALLETE and its subsidiaries, collectively.

Our core operations in 42 states and nine Canadian provinces focus on two segments:

ENERGY SERVICES includes electric and gas services, coal mining and telecommunications; and

AUTOMOTIVE SERVICES includes a network of wholesale and "total loss" vehicle auctions, a finance company, a vehicle remarketing company, a company that provides vehicle inspection services to the automotive industry and its lenders, and a company that provides Internet-based parts location and insurance claim audit services nationwide.

Under INVESTMENTS AND CORPORATE CHARGES we capture our real estate operations, investments in emerging technologies related to the electric utility industry, a securities portfolio and corporate charges. Corporate charges represent general corporate expenses, including interest, not specifically related to any one business segment.

In September 2001 we initiated a strategic review of all of the Company's businesses to identify ways of unlocking shareholder value not reflected in the price of our common stock. During the review process certain businesses were identified as having more value to potential purchasers than to us and have been included in discontinued operations. Discontinued operations include water and wastewater services in Florida, North Carolina and Georgia and our auto transport company.

We anticipate selling our auto transport company by the end of first quarter 2002 and our Water Services businesses before the end of 2002. We anticipate selling our Water Services businesses at a significant gain, providing us with additional liquidity and financial strength. Net proceeds from these sales will be used to fund growth initiatives and may be used to pay down debt.

As of December 31, 2001 we had approximately 14,000 employees, 4,000 of which were part time.

In 2001 Energy Services purchased the electric generating facilities of LTV (Taconite Harbor Energy Center) and is working to complete maintenance activities and restart 225 MW of generation in the first half of 2002. In 2001 we initiated permitting for a planned 225-MW co-generation energy facility adjacent to the Blandin Paper facility in Grand Rapids, Minnesota and the proposed addition of 160 MW of generation in Wisconsin. Energy Services also received significant regulatory approvals during 2001 to construct in partnership with Wisconsin Public Service Corporation a 220-mile, 345-kV transmission line from Duluth, Minnesota to Wausau, Wisconsin. In July 2001 Energy Services added Enventis Telecom, an integrated data services provider, to its telecommunications business. (See Energy Services.)

In 2001 Automotive Services acquired one wholesale auction facility and increased its "total loss" vehicle auctions by 13. These additions combined with the acquisition of ComSearch, which provides Internet-based parts location and insurance claim audit services, established ADESA as the third largest provider of "total loss" vehicle services in North America.

In 2001 Investments reported record sales by its real estate operations.

YEAR ENDED DECEMBER 31	2001	2000	1999
CONSOLIDATED OPERATING REVENUE - Millions	$1,528	$1,190	$996
PERCENTAGE OF CONSOLIDATED OPERATING REVENUE			
ENERGY SERVICES			
Retail			
Industrial			
Taconite Producers	10%	14%	15%
Paper and Wood Products	4	5	6
Pipelines and Other Industries	3	3	3
Total Industrial	17	22	24
Residential	5	6	6
Commercial	5	6	7
Sales to Other Power Suppliers	4	5	8
Other Revenue	10	10	11
Total Energy Services	41	49	56
AUTOMOTIVE SERVICES	54	44	38
INVESTMENTS	5	7	6
	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 Notes 1 and 2.

ENERGY SERVICES

The businesses we include in Energy Services generate, transmit, distribute, market and trade electricity. Coal mining and telecommunications are also included. The discussion below summarizes the major businesses we include in Energy Services. Statistical information is presented as of December 31, 2001. All subsidiaries are wholly owned unless otherwise specifically indicated.

MINNESOTA POWER, a division of ALLETE, provides electricity in a 26,000 square mile electric service territory located in northeastern Minnesota. Minnesota Power supplies retail electric service to 131,000 customers and wholesale electric service to 16 municipalities. SWL&P sells electricity and natural gas, and provides water service in northwestern Wisconsin. SWL&P has 14,000 electric customers, 12,000 natural gas customers and 10,000 water customers.

Minnesota Power had an annual net peak load of 1,376 MW on January 2, 2001. Our power supply sources are shown below.

We have electric transmission and distribution lines of 500 kV (8 miles), 230 kV (606 miles), 161 kV (43 miles), 138 kV (66 miles), 115 kV (1,259 miles) and less than 115 kV (6,550 miles). We own and operate 178 substations with a total capacity of 8,550 megavoltamperes. Some of our transmission and distribution lines interconnect with other utilities.

We own offices and service buildings, an energy control center, and repair shops, and lease offices and storerooms in various localities. Substantially all of our electric plant is subject to mortgages which collateralize our outstanding first mortgage bonds. Generally, our properties are held by the Company in fee and are free from other encumbrances, subject to minor exceptions. Some of our electric lines are located on land not owned in fee, but are covered by necessary permits of governmental authorities or by appropriate easement rights. WPPI owns 20% of Boswell Unit 4. WPPI has the right to use our transmission line facilities to transport its share of generation. (See Note 14.)

In January 2002 Minnesota Power announced MPEX, our power marketing and trading division which buys and sells capacity and energy in the wholesale power market, will be transferred to Split Rock Energy. The transfer, which is expected to occur in March 2002, will facilitate Split Rock Energy's plans to grow by adding new members and providing trading and related services to others. Split Rock Energy currently contracts for wholesale power marketing and trading services exclusively from MPEX. During 2000 Minnesota Power and Great River formed Split Rock Energy. With headquarters in Elk River, Minnesota, Great River is a consumer-owned generation and transmission cooperative and is Minnesota's second largest utility in terms of generating capacity. Split Rock Energy combines the two companies' power supply capabilities and customer loads for power pool operations and generation outage protection. Ownership of generation assets and current customer supply arrangements have not changed for either company. Split Rock Energy will continue to have access to members' resources, assets and financial support.

POWER SUPPLY	UNIT NO.	YEAR INSTALLED	NET WINTER CAPABILITY
			MW
Steam			
Coal-Fired			
Boswell Energy Center			

near Grand Rapids, MN	1	1958	69
	2	1960	69
	3	1973	351
	4	1980	425
			914
Laskin Energy Center in Hoyt Lakes, MN	1	1953	55
	2	1953	55
			110
Purchased Steam			
M.L. Hibbard in Duluth, MN	3 & 4	1949, 1951	49
Total Steam			1,073
Hydro			
Group consisting of ten stations in MN		Various	115
Purchased Power			
Square Butte burns lignite coal near Center, ND			322
All Other - Net			-
Total Purchased Power			322
Total			1,510

BNI COAL owns and operates a lignite mine in North Dakota. Two electric generating cooperatives, Minnkota Power and Square Butte, presently consume virtually all of BNI Coal's production of lignite coal under cost-plus coal supply agreements expiring in 2027. (See Fuel and Note 13.) A large dragline, shop complex and other property at BNI Coal are leased under a leveraged lease agreement that expires in 2002. During 2000 BNI Coal entered into an agreement to purchase in 2002 all property and equipment subject to this lease for $4.7 million.

ENVENTIS TELECOM. Our telecommunications subsidiaries, MP Telecom and Enventis, Inc. (acquired in July 2001), are being merged to operate as Enventis Telecom. Enventis Telecom is an integrated data services provider offering fiber optic-based communication and advanced data services to businesses and communities in Minnesota and Wisconsin. Enventis Telecom provides converged IP (or Internet protocol) services that allow all communications (voice, video and data) to use the same delivery technology. Enventis Telecom owns or has rights to approximately 1,500 route miles of fiber optic cable. These route miles contain multiple fibers that total approximately 47,500 fiber miles. Enventis Telecom also owns optronic and data switching equipment that is used to "light up" the fiber optic cable and provides customer bandwidth services. Enventis Telecom services customers from facilities that are primarily leased from third parties.

RAINY RIVER ENERGY is engaged in the acquisition and development of merchant generation and wholesale power marketing. Merchant generation is non-rate base generation sold at wholesale at market-based rates, pursuant to authority from the FERC.

RETAIL ELECTRIC SALES

Approximately 62% of the ore consumed by integrated steel facilities in the United States originates from five taconite customers of Minnesota Power. Taconite, an iron-bearing rock of relatively low iron content that is abundantly available in Minnesota, is an important domestic source of raw material for the steel industry. Taconite processing plants use large quantities of electric power to grind the ore-bearing rock, and agglomerate and pelletize the iron particles into taconite pellets. Annual taconite production in Minnesota was 33 million tons in 2001 (47 million tons in 2000; 43 million tons in 1999). The decrease in 2001 taconite production was due to the closing of LTV, which was not a Large Power Customer (defined below), and reduced demand for iron ore from the operating mines as a result of high steel import levels and a softer economy. Based on our research of the taconite industry, Minnesota taconite production for 2002 is anticipated to be about 36 million tons. While taconite production is currently expected to continue at annual levels of about 35 million tons, the longer-term outlook of this cyclical industry is less certain. We expect any excess energy not used by our Large Power Customers will be marketed through Split Rock Energy.

LARGE POWER CUSTOMER CONTRACTS. Minnesota Power has large power customer contracts with 12 customers (Large Power Customers), each of which requires 10 MW or more of generating capacity. Large Power Customer contracts require Minnesota Power to have a certain amount of generating capacity available. (See table on next page.) 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 bi-annual (power pool season) basis and require that a portion of their megawatt needs be committed on a take-or-pay basis for the entire term of the agreement. In addition to the demand charge, each Large Power Customer is billed an energy charge for each kilowatthour used that recovers the variable costs incurred in generating electricity. Six of the Large Power Customers have interruptible service for a portion of their needs which provides a discounted demand rate and energy priced at Minnesota Power's incremental cost after serving all firm power obligations. Minnesota Power also provides incremental production service for customer demand levels above the contract 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. Contracts with 10 of the 12 Large Power Customers provide for deferral without interest of one-half of demand charge obligations incurred during the first three months of a strike or illegal walkout at a customer's facilities, with repayment required over the 12-month period following resolution of the work stoppage.

Each contract continues past the contract termination date unless the required four-year advance notice of cancellation has been given. Such contracts minimize the impact on earnings that otherwise would result from significant reductions in kilowatthour sales to such customers. Large Power Customers are required to purchase any 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 Issues - Electric Rates.)

MINIMUM REVENUE AND DEMAND UNDER CONTRACT
AS OF FEBRUARY 1, 2002

	MINIMUM ANNUAL REVENUE	MONTHLY MEGAWATTS

2002	$79.3 million	523
2003	$65.2 million	385
2004	$58.3 million	344
2005	$41.9 million	250
2006	$30.9 million	183

BASED ON PAST EXPERIENCE AND PROJECTED OPERATING LEVELS, WE BELIEVE REVENUE FROM LARGE POWER CUSTOMERS WILL BE SUBSTANTIALLY IN EXCESS OF THE MINIMUM CONTRACT AMOUNTS.

CONTRACT STATUS FOR MINNESOTA POWER LARGE POWER CUSTOMERS
AS OF FEBRUARY 1, 2002

CUSTOMER	INDUSTRY	LOCATION	OWNERSHIP
Eveleth Mines LLC	Taconite	Eveleth, MN	45% Rouge Ste 40% AK Steel 15% Stelco In
Hibbing Taconite Co.	Taconite	Hibbing, MN	70.3% Bethleh 15% Cleveland 14.7% Stelco
Ispat Inland Mining Company	Taconite	Virginia, MN	Ispat Inland
National Steel Pellet Co.	Taconite	Keewatin, MN	National Stee
USX Corporation	Taconite	Mt. Iron, MN	USX Corporati
Blandin Paper Company	Paper	Grand Rapids, MN	UPM-Kymmene C
Boise Cascade Corporation	Paper	International Falls, MN	Boise Cascade
Potlatch Corporation	Paper, Pulp and Wood Products	Cloquet, MN Brainerd, MN Grand Rapids, MN	Potlatch Corp
Stora Enso North America, Duluth Paper Mill and Duluth Recycled Pulp Mill	Paper and Pulp	Duluth, MN	Stora Enso
USG Interiors, Inc.	Manufacturer	Cloquet, MN	USG Corporati
Enbridge Energy Company, Limited Partnership	Pipeline	Deer River, MN Floodwood, MN	Enbridge Ener Limited Par
Minnesota Pipeline Company	Pipeline	Staples, MN Little Falls, MN Park Rapids, MN	60% Koch Pipe 40% Marathon Petroleum L

PURCHASED POWER AND CAPACITY SALES

A purchase or sale is generally made to balance the supply or demand, thereby capping the cost of power or fixing a margin. Minnesota Power's risk management policy, contract provisions, operational flexibility, credit policy and procedures for purchasing power to cap cost or fix margins are designed to minimize Minnesota Power's risk and exposure in a market with volatile prices.

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 71% of the output of a 455-MW coal-fired generating unit located near Center, North Dakota. (See Note 13.)

In October 2000 Minnesota Power entered into a power purchase agreement with Great River. Under this agreement Minnesota Power purchased 240 MW beginning June 2001 until April 2003 and 80 MW from May 2003 to April 2004 from Lakefield Junction Station, a natural gas-fired peaking plant located in southern Minnesota.

For capacity sales see Wholesale Electric Sales.

FUEL

Minnesota Power purchases low-sulfur, sub-bituminous coal from the Powder River Basin coal field located in Montana and Wyoming. Coal consumption in 2001 for electric generation at Minnesota Power's Minnesota coal-fired generating stations was about 4.5 million tons. As of December 31, 2001 Minnesota Power had a coal inventory of about 535,000 tons. Minnesota Power has four coal supply agreements with Montana suppliers. Under these agreements Minnesota Power has the tonnage flexibility to procure 70% to 100% of its total coal requirements. Minnesota Power will obtain coal in 2002 under these agreements and in the spot market. This mix of coal supply options allows Minnesota Power to manage market price and supply risk and to take advantage of favorable spot market prices. Minnesota Power is exploring future coal supply options and believes that adequate supplies of low-sulfur, sub-bituminous coal will continue to be available.

The Burlington Northern and Santa Fe Railway Company transports coal by unit train from the Powder River Basin to Minnesota Power's generating stations. In 2001 Minnesota Power and Burlington Northern entered into a 10-year agreement under which Burlington Northern will ship all of Minnesota Power's coal needs to the Boswell Energy Center

near Grand Rapids, Minnesota, to the Laskin Energy Center in Hoyt Lakes, Minnesota, and to Taconite Harbor Energy Center near Schroeder, Minnesota, through 2011.

COAL DELIVERED TO MINNESOTA POWER YEAR ENDED DECEMBER 31	2001	2000	1999
Average Price Per Ton	$20.52	$21.19	$20.60
Average Price Per MBtu	$1.18	$1.16	$1.14

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 expiring in 2027. Square Butte's cost of lignite burned in 2001 was approximately 76 cents per MBtu. The lignite acreage 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 the fuel for the anticipated useful life of the generating unit.

WHOLESALE ELECTRIC SALES

Minnesota Power has wholesale contracts with a number of municipal customers. See Regulatory Issues - Federal Energy Regulatory Commission.)

In an increasingly volatile wholesale marketplace, Minnesota Power's Split Rock Energy alliance mitigates marketplace risk while creating additional marketing opportunities for both Minnesota Power and Great River. MPEX, which is expected to transfer its operations to Split Rock Energy by March 2002, provides power trading and marketing, energy sourcing and risk management services to Split Rock Energy. Split Rock Energy's risk management policies are consistent with Minnesota Power's.

In September 1999 Rainy River Energy entered into an amended 15-year power purchase agreement with a company that was subsequently purchased by NRG Energy, Inc., an independent power producer. The agreement includes the purchase of the output of one entire unit (approximately 275 MW) of a four unit (approximately 1,100 MW) natural gas-fired combined cycle generation facility located near Chicago, Illinois. Construction of the generation facility began in 2000 and completion is expected in April 2002. Rainy River Energy will be obligated to pay fixed capacity related charges beginning May 1, 2002. Rainy River Energy has entered into a 15-year agreement to sell approximately 50 MW, has a 10-year agreement to sell another 50 MW and is engaged in wholesale marketing of the remaining electrical power. Under the terms of the resale agreements, the buyers will pay a charge for capacity made available and energy delivered starting May 1, 2002 and procure their own fuel. Rainy River Energy plans to arrange for its fuel supply through a blend of purchases including spot market and hedges structured to match the wholesale marketing of the remaining electrical power. It is currently expected that the agreement with NRG Energy, Inc. and resale contracts will be transferred to Minnesota Power, which will market the remaining wholesale power produced by this unit through Split Rock Energy. Minnesota Power expects the agreement will enhance its ability to serve an expanding customer base within the MISO region (See Regulatory Issues - Federal Energy Regulatory Commission), as well as enable additional participation in the wholesale bulk power marketplace.

In June 1999 Minnesota Power announced plans to build a natural gas-fired, combustion turbine power plant near Superior, Wisconsin. Unavailability of combustion turbines led to a decision to purchase near-term peaking capacity from Great River's new Lakefield Junction Station for 2001 to 2004. In August 2001 Minnesota Power announced that its subsidiary, Rainy River Energy Corporation - Wisconsin was proceeding with the permitting for a 160-MW merchant peaking plant in Superior expected to be in service in late 2003. Rainy River Energy Corporation - Wisconsin has sold 100 MW of the plant output under a long-term contract.

In August 2001 Minnesota Power and UPM-Kymmene, the owner of Blandin Paper, proposed a state-of-the-art energy facility adjacent to Blandin Paper in Grand Rapids, Minnesota, through a partnering arrangement. A new company, Rapids Power LLC, was created to own the facility. Rainy River Energy owns 71.5% of Rapids Power and Blandin Paper owns 28.5%. Rapids Power plans to build a low-sulfur sub-bituminous coal-fired generating facility designed to satisfy up to 40% of its fuel requirements by burning renewable biomass fuel, such as wood waste. The project, which is expected to cost Minnesota Power $200 million, is contingent on timely receipt of necessary federal and state approvals and permits and final approval by Blandin Paper and Minnesota Power.

In October 2001 Rainy River Energy completed a transaction with LTV and

Cleveland-Cliffs to acquire the 225-MW Taconite Harbor Energy Center and other non-mining assets for $75 million. One of the three 75-MW units in this facility was re-started for commercial operation in January 2002. The other units are expected to be on-line by May 2002. Rainy River Energy has filed the necessary market-based rate tariff applications with FERC to sell in the wholesale market by Split Rock Energy. In December 2001 Minnesota Power requested approval from the MPUC to acquire the ownership of the facility. Under Minnesota Power ownership, the generation output would still be sold in the wholesale market and it is anticipated that only in limited circumstances could some of the energy be allocated to Minnesota Power customers through Split Rock Energy.

REGULATORY ISSUES

We are exempt from regulation under the Public Utility Holding Company Act of 1935, except as to Section 9(a)(2) which relates to acquisition of securities of public utility companies.

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, and certain accounting and record keeping practices. The PSCW has regulatory authority over the retail sales of electricity, water and gas by SWL&P. The MPUC, FERC and PSCW had regulatory authority over 25%, 3% and 3%, respectively, of our 2001 consolidated operating revenue.

ELECTRIC RATES. Minnesota Power has historically designed 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, and recovery of current and deferred CIP expenditures.

In addition to Large Power Customer contracts, Minnesota Power also has contracts with large industrial and commercial customers with monthly demands of more than 2 MW but less than 10 MW of capacity. The terms of these contracts vary depending upon the customer's demand for power and the cost of extending Minnesota Power's facilities to provide electric service.

Minnesota Power requires that all large industrial and commercial customers under contract specify the date when power is first required, and thereafter the customer is billed 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 contracts provide that new rates which have been approved by appropriate regulatory authorities will be substituted immediately for existing rates, without regard to any unexpired term of the existing contract. All rates and other contract terms are subject to approval by appropriate regulatory authorities.

FEDERAL ENERGY REGULATORY COMMISSION. The FERC has jurisdiction over our wholesale electric service and open access transmission service. Minnesota Power's hydroelectric facilities, which are located in Minnesota, are licensed by the FERC. (See Environmental Matters - Water.)

Minnesota Power has long-term contracts with 16 Minnesota municipalities receiving wholesale electric service. Three contracts are for service through 2002 and 2005, while the other 13 are for service through at least 2007. The contracts limit rate increases (including fuel costs) to about 2% per year on a cumulative basis. In 2001 municipal customers purchased 688,000 MWh from Minnesota Power.

Effective February 28, 2001 Minnesota Power and SWL&P became members of the MISO pursuant to FERC's Order No. 2000 and Wisconsin state law. Minnesota Power and SWL&P retain ownership of their respective transmission assets and control area functions, but will operate their transmission network under the regional operational control of the MISO and take and provide transmission service under the MISO tariff. On December 19, 2001 FERC approved MISO as the nation's first regional transmission organization (RTO) under Order No. 2000 criteria, noting that it believes the MISO will benefit the public interest by enhancing the reliability of the Midwest electric grid and facilitating and enhancing wholesale competition. The MISO will accomplish this primarily through standardization of rates, terms and conditions of transmission service over a broad region encompassing all or parts of 20 states and one Canadian province, and over 120,000 MW of generating capacity MISO operations are phasing in during the first half of 2002.

Minnesota Power also participates in MAPP, a power pool operating in parts of eight states in the Upper Midwest and in three provinces in Canada. MAPP functions include a regional reliability council that maintains generation reserve sharing requirements and a wholesale power and energy market committee.

MINNESOTA PUBLIC UTILITIES COMMISSION. Minnesota Power's retail rates are based on a 1994 MPUC retail rate order that allows for an 11.6% return on common equity dedicated to utility plant.

Minnesota requires investor owned electric utilities to spend a minimum of 1.5% of gross annual retail electric revenue on conservation improvement programs (CIP) 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 recovery, all CIP expenditures as well as a carrying charge on the deferred account balance, which was $0.3 million at December 31, 2001. During 1999 the Minnesota legislature enacted Minnesota Power-supported legislation allowing customers with 20 MW or more of connected load at one service point to opt out of the CIP minimum spending requirements, and associated expense recovery, upon showing the MPUC that they had implemented all reasonably available conservation measures. Opt outs were approved in early 2000 for seven of Minnesota Power's industrial customers. The 2000/2001 CIP investment goal was $2.7 million each year with actual spending at $1.9 million and $2.6 million, respectively. Minnesota Power has addressed the shortfall with the Minnesota Department of Commerce, the agency with authority over CIP spending programs, and expects to resolve the spending shortfall during 2002.

Until 1999 the MPUC approved Minnesota Power's request to recover lost margins. Lost margins represented energy sales lost over a five-year period due to Minnesota Power's efforts to assist customers in conserving energy. Lost margin recovery compensated utilities for reduced sales resulting from CIP activities. In 1999 the MPUC denied Minnesota Power's request to recover $3.5 million of lost margins related to 1998 CIP activities. Minnesota Power appealed the decision to the Minnesota Court of Appeals. In December 2000 the court reversed the MPUC's denial of Minnesota Power's 1998 lost margin claim. The court found that the MPUC's action constituted retroactive ratemaking and was arbitrary and capricious. The MPUC appealed the court's decision to the Minnesota Supreme Court, which denied the appeal in February 2001. Minnesota Power subsequently requested and was granted approval to recover the 1998 lost margins and associated carrying charges during 2001. The recovery was completed in 2001.

PUBLIC SERVICE COMMISSION OF WISCONSIN. SWL&P's current retail rates are based on a September 2001 PSCW retail rate order that allows for a 12.25% return on common equity.

In 1999 Minnesota Power and Wisconsin Public Service Corporation (WPS) announced plans to construct a 220-mile, 345-kV Duluth-to-Wausau electric transmission line. The proposal, called "Power Up Wisconsin," is a direct response to former Wisconsin Governor Thompson's call to address the pressing need for more dependable electricity in Wisconsin and the Upper Midwest. In March 2001 the Minnesota Environmental Quality Board (MEQB) approved the Minnesota portion of the line. In August 2001 the PSCW unanimously agreed that construction of the line is necessary and in October 2001 issued its written order that outlines the details and route specifics of the line. Appeals are pending in Wisconsin. Depending on the outcome of the pending appeals, the new transmission line could be in service in 2005 at an estimated cost of $200 million. Approximately $30 million to $40 million of the estimated cost is for facilities in Minnesota that may be owned by Minnesota Power.

The PSCW must approve the ownership, control and operation of any affiliated wholesale merchant generating plants in Wisconsin. (See Wholesale Electric Sales.)

COMPETITION

INDUSTRY RESTRUCTURING. The electric utility industry continues to restructure itself in response to growing competition at both the wholesale and retail levels. This restructuring has primarily affected Minnesota Power's wholesale power marketing and trading activity through Split Rock Energy, discussed above. New legislation and regulation that aims to maintain reliability, assure adequate energy supply, and address wholesale price volatility while encouraging wholesale competition is being considered at the federal level. Over one-half the states representing approximately 70% of the United States population have passed either legislation or regulation that initiates a process which may lead to retail customer choice. These initiatives lack momentum in Minnesota and Wisconsin. Legislative and regulatory activity, as well as the actions of competitors affect the way Minnesota Power strategically plans for its future. 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 90 cities and towns located within its electric service territory. SWL&P holds franchises in 15 cities and towns within its service territory. The remaining cities and towns served do not require a franchise to operate within their boundaries.

ENVIRONMENTAL MATTERS

Certain businesses included in our Energy Services segment are subject to regulation by various federal, state and local authorities about air quality, water quality, solid wastes and other environmental matters. We consider these businesses to be in substantial compliance with those environmental regulations currently applicable to their operations and believe all necessary permits to conduct such operations have been obtained. We do not currently anticipate that potential capital expenditures for environmental matters will be material. However, because environmental laws and regulations are constantly evolving, the character, scope and ultimate costs of environmental compliance cannot be estimated.

AIR. Minnesota Power's generating facilities in Minnesota burn mainly low-sulfur western coal and Square Butte, located in North Dakota, burns lignite coal. All of these facilities are equipped with pollution control equipment such as scrubbers, baghouses or electrostatic precipitators. The federal Clean Air Act Amendments of 1990 (Clean Air Act) created emission allowances for sulfur dioxide. Each allowance is an authorization to emit one ton of sulfur dioxide, and each utility must have sufficient allowances to cover its annual emissions. Sulfur dioxide emission requirements are currently being met by all of Minnesota Power's generating facilities, creating a surplus allowance situation for Minnesota Power. Square Butte anticipates meeting its sulfur dioxide requirements through increased use of existing scrubbers and by annually purchasing additional allowances as necessary.

In accordance with the Clean Air Act, the EPA has established nitrogen oxide limitations for electric generating units. To meet nitrogen oxide limitations, Minnesota Power installed advanced low-emission burner technology and associated control equipment to operate the Boswell and Laskin facilities at or below the compliance emission limits. Nitrogen oxide limitations at Square Butte are being met by

combustion tuning. Minnesota Power has obtained all necessary Title V air operating permits from the Minnesota Pollution Control Agency for its applicable facilities to conduct electric operations.

In December 2000 the EPA announced their decision to regulate mercury emissions from coal and oil-fired power plants under Section 112 of the Clean Air Act. Section 112 will require all such power plants in the United States to adhere to the EPA maximum achievable control technology (MACT) standards for mercury. The EPA's announcements clarified that the EPA will establish applicable mercury MACT standards through a four-year rule-making and public comment period, giving consideration to factors such as a facility's installed design and operation. Final regulations defining control requirements are planned for December 2004. Cost estimates are premature at this time.

In December 2000 Minnesota Power received a request from the EPA, under Section 114 of the Clean Air Act, seeking information regarding capital expenditures at all of its coal-fired generating stations. This action is part of an industry-wide investigation assessing compliance with the New Source Review and the New Source Performance Standards (emissions standards that apply to new and changed units) of the Clean Air Act at electric generating stations. We are unable to predict whether the EPA will take any further action on this matter or whether Minnesota Power will be required to incur any costs as a result. An EPA statement on prospective New Source Review revisions is expected in early 2002.

WATER. The Federal Water Pollution Control Act of 1972 (FWPCA), as amended by the Clean Water Act of 1977 and the Water Quality Act of 1987, established the National Pollutant Discharge Elimination System (NPDES) permit program. The FWPCA requires NPDES permits to be obtained from the EPA (or, when delegated, from individual state pollution control agencies) for any wastewater discharged into navigable waters. Minnesota Power has obtained all necessary NPDES permits, including NPDES storm water permits for applicable facilities, to conduct its electric operations.

Minnesota Power holds FERC licenses authorizing the ownership and operation of seven hydroelectric generating projects with a total generating capacity of about 118 MW. In June 1996 Minnesota Power filed in the U.S. Court of Appeals for the District of Columbia Circuit a petition for review of the license as issued by the FERC for Minnesota Power's St. Louis River Hydro Project. Separate petitions for review were also filed by the U.S. Department of the Interior and the Fond du Lac Band of Lake Superior Chippewa (Fond du Lac Band), two intervenors in the licensing proceedings. The court consolidated the three petitions for review and suspended the briefing schedule while Minnesota Power and the Fond du Lac Band negotiate the reasonable fee for use of tribal lands as mandated by the new license. Both parties informed the court that these negotiations may resolve other disputed issues, and they are obligated to report to the court periodically the status of these discussions. Beginning in 1996, and most recently in January 2002, Minnesota Power filed requests with the FERC for extensions of time to comply with certain plans and studies required by the license that might conflict with the settlement discussions. In 2001 the Fond du Lac Band and Minnesota Power reached a confidential settlement agreement for the St. Louis River Hydro Project. The Fond du Lac Band and Minnesota Power have included the U.S. Department of Interior in the settlement process in an effort to achieve a comprehensive agreement with all intervening parties to the project license. Any final settlement must be approved by the FERC, who would then amend the project license in accordance with the settlement agreement.

SOLID AND HAZARDOUS WASTE. The Resource Conservation and Recovery Act of 1976 regulates the management and disposal of solid wastes and hazardous wastes. As a result of this legislation, the EPA has promulgated various hazardous waste rules. Minnesota Power is required to notify the EPA of hazardous waste activity and routinely submits the necessary annual reports to the EPA.

Rainy River Energy is in the permitting process to construct, in early 2002, a dry ash disposal landfill to handle ash generated from the Taconite Harbor Energy Center at a cost estimated to be $800,000.

In response to EPA Region V's request for utilities to participate in the Great Lakes Initiative by voluntarily removing remaining polychlorinated biphenyl (PCB) inventories, Minnesota Power has scheduled replacement of PCB-contaminated oil by the end of 2004. The total cost is expected to be between $2.5 million and $3 million, of which $1.1 million was spent through December 31, 2001.

AUTOMOTIVE SERVICES

Automotive Services includes several subsidiaries that are integral parts of the vehicle redistribution business. Vehicle sales within the auto auction industry are expected to rise at a rate of 2% to 3% annually through 2003. Automotive Services plans to grow through increased sales at existing businesses, selective acquisitions in both wholesale and "total loss" vehicle auction facilities, integration of "total loss" vehicle services at certain wholesale vehicle auction facilities and expansion of services to customers. The discussion below summarizes the major businesses we include in Automotive Services. Statistical information is presented as of December 31, 2001. All subsidiaries are wholly owned.

ADESA is the second largest wholesale vehicle auction network in North America. Headquartered in Indianapolis, Indiana, ADESA owns (or leases) and operates 53 wholesale vehicle auction facilities in the United States and Canada through which used cars and other vehicles are sold to franchised automobile dealers and licensed used car dealers. Sellers at ADESA's auctions include domestic and foreign auto manufacturers, car dealers, automotive fleet/lease companies, banks and finance companies.

The table on the next page lists the vehicle auctions owned or leased by ADESA. Each auction has a multi-lane, drive-through auction facility, as well as additional buildings for reconditioning, registration, maintenance, bodywork, and other ancillary and administrative services. Each auction also has secure parking areas to store vehicles for auction.

ADESA IMPACT in the U.S. and IMPACT AUTO in Canada, collectively ADESA Impact, represent the third largest "total loss" vehicle service business in North America. They provide "total loss" vehicle services to the property and casualty insurance industry, and vehicle leasing and rental car companies. ADESA Impact provides "total loss" vehicle claim services such as vehicle appraisals, inspections, evaluations, titling and settlement administration to its clients. Auto imaging, Internet bidding and vehicle enhancement services are provided through an array of "total loss" management programs. ADESA Impact has 23 "total loss" auction facilities in the United States and Canada. United States operations are based in Rhode Island and Canadian operations are headquartered in Toronto.

COMSEARCH provides professional claim outsourcing services to the property and casualty insurance industry and is the nation's largest automobile recycled part locating service, processing over 100,000 part searches a month. Our locating service has over 2,300 customers. ComSearch's services compliment ADESA Impact's business. ComSearch is headquartered in Warren, Rhode Island.

AFC provides inventory financing for wholesale and retail automobile dealers who purchase vehicles from ADESA auctions, independent auctions, other auction chains and outside sources. AFC is headquartered in Indianapolis, Indiana, and has 82 loan production offices at or near auto auctions across North America. These offices provide qualified dealers credit to purchase vehicles at any of the 400 plus auctions approved by AFC. AFC's computer-based system follows each loan from origination to payoff and allows AFC to better manage its business, while expediting services through its branch network to 18,000 registered dealers.

PAR, which is doing business as PAR North America, provides customized vehicle remarketing services to various companies such as banks, non-prime finance companies, captive finance, leasing companies, commercial fleets and rental car companies throughout the United States. PAR's services include nationwide repossessions, remarketing, pre- and post-term lease-end management, 50-state titling services and Canadian registrations turned to U.S. titles. PAR offers its telemarketing service through its affiliate company, EndTrust. PAR, together with another affiliate company ADESA Importation, offer a complete range of vehicle importation services. PAR has its headquarters in Carmel, Indiana.

AUTOVIN provides technology-enabled vehicle inspection services and inventory auditing to the automotive industry and the industry's secured lenders. AutoVIN's services include vehicle condition reporting, inventory verification auditing, program compliance auditing and facility inspection. AutoVIN works closely with AFC to offer auto dealers one-stop shopping for financial and information services.

ADESA IMPORTATION is headquartered in Holly, Michigan, with additional facilities in Buffalo, New York; Grand Forks, North Dakota; Sweetgrass, Montana; and Blaine, Washington. ADESA Importation is the largest independent, commercial registered importer of vehicles in the United States. It provides a full range of importation services, including marshalling, transportation, brokerage, titling, tax processing and speedometer/odometer conversions from metric to the U.S. measuring system.

ADESA AUCTIONS	CITY	STATE/ PROVINCE	OP CO
UNITED STATES			
ADESA Birmingham	Moody	Alabama	
ADESA Phoenix	Chandler	Arizona	
ADESA Central Arkansas			