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ALLETE INC  
Form 10-K  
February 15, 2018

United States  
Securities and Exchange Commission  
Washington, D.C. 20549  
Form 10-K  
(Mark  
One)

T Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 2017

£ 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 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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

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filer”, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):  
Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer   
Smaller Reporting Company  Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

The aggregate market value of voting stock held by nonaffiliates on June 30, 2017, was \$3,637,956,646.

As of February 1, 2018, there were 51,143,656 shares of ALLETE Common Stock, without par value, outstanding.

Documents Incorporated By Reference

Portions of the Proxy Statement for the 2018 Annual Meeting of Shareholders are incorporated by reference in Part III.

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Index	
<u>Definitions</u>	4
<u>Forward-Looking Statements</u>	6
<u>Part I</u>	8
<u>Item 1.</u>	8
<u>Business</u>	8
<u>Regulated Operations</u>	9
<u>Electric Sales/Customers</u>	9
<u>Seasonality</u>	12
<u>Power Supply</u>	12
<u>Transmission and Distribution</u>	14
<u>Investment in ATC</u>	15
<u>Properties</u>	15
<u>Regulatory Matters</u>	16
<u>Regional Organizations</u>	17
<u>Minnesota Legislation</u>	18
<u>Competition</u>	18
<u>Franchises</u>	19
<u>Energy Infrastructure and Related Services</u>	19
<u>ALLETE Clean Energy</u>	19
<u>U.S. Water Services</u>	20
<u>Corporate and Other</u>	21
<u>BNI Energy</u>	21
<u>ALLETE Properties</u>	21
<u>Non-Rate Base Generation and</u>	22
<u>Miscellaneous Environmental</u>	22
<u>Matters</u>	22
<u>Employees</u>	23
	23

<u>Availability of Information</u>	
<u>Executive Officers of the Registrant</u>	<u>24</u>
<u>Item 1A. Risk Factors</u>	<u>25</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>32</u>
<u>Item 2. Properties</u>	<u>32</u>
<u>Item 3. Legal Proceedings</u>	<u>33</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>33</u>
<u>Part II</u>	<u>33</u>
<u>Item 5. Market for Registrant's Common Equity. Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>33</u>
<u>Item 6. Selected Financial Data</u>	<u>35</u>
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>35</u>
<u>Overview</u>	<u>36</u>
<u>2017</u>	
<u>Compared to 2016</u>	<u>38</u>
<u>2016</u>	
<u>Compared to 2015</u>	<u>42</u>
<u>Critical Accounting Policies</u>	<u>46</u>

<u>Outlook</u>	<u>48</u>
<u>Liquidity and</u>	
<u>Capital</u>	<u>56</u>
<u>Resources</u>	
<u>Capital</u>	
<u>Requirements</u>	<u>59</u>
<u>Environmental</u>	
<u>and Other</u>	<u>60</u>
<u>Matters</u>	
<u>Market Risk</u>	<u>60</u>
<u>Recently</u>	
<u>Adopted</u>	
<u>Accounting</u>	<u>61</u>
<u>Standards</u>	
<u>Item 7A.</u>	
<u>Quantitative</u>	
<u>and Qualitative</u>	
<u>Disclosures</u>	<u>61</u>
<u>about Market</u>	
<u>Risk</u>	
<u>Item 8.</u>	
<u>Financial</u>	
<u>Statements and</u>	<u>62</u>
<u>Supplementary</u>	
<u>Data</u>	
<u>Item 9.</u>	
<u>Changes in and</u>	
<u>Disagreements</u>	
<u>with</u>	
<u>Accountants on</u>	<u>62</u>
<u>Accounting and</u>	
<u>Financial</u>	
<u>Disclosure</u>	

Index	
<u>Item 9A.</u>	
<u>Controls and</u>	<u>62</u>
<u>Procedures</u>	
<u>Item 9B. Other</u>	<u>62</u>
<u>Information</u>	
<u>Part III</u>	<u>63</u>
<u>Item 10.</u>	
<u>Directors.</u>	
<u>Executive</u>	<u>63</u>
<u>Officers and</u>	
<u>Corporate</u>	
<u>Governance</u>	
<u>Item 11.</u>	
<u>Executive</u>	<u>63</u>
<u>Compensation</u>	
<u>Item 12. Security</u>	
<u>Ownership of</u>	
<u>Certain</u>	
<u>Beneficial</u>	
<u>Owners and</u>	<u>64</u>
<u>Management and</u>	
<u>Related</u>	
<u>Stockholder</u>	
<u>Matters</u>	
<u>Item 13. Certain</u>	
<u>Relationships</u>	
<u>and Related</u>	<u>64</u>
<u>Transactions, and</u>	
<u>Director</u>	
<u>Independence</u>	
<u>Item 14.</u>	
<u>Principal</u>	<u>64</u>
<u>Accounting Fees</u>	
<u>and Services</u>	
<u>Part IV</u>	<u>65</u>
<u>Item 15. Exhibits</u>	
<u>and Financial</u>	<u>65</u>
<u>Statement</u>	
<u>Schedules</u>	
<u>Item 16. Form</u>	<u>70</u>
<u>10-K Summary</u>	
<u>Signatures</u>	<u>71</u>
<u>Report of Independent</u>	<u>73</u>
<u>Registered Public</u>	
<u>Accounting Firm</u>	

<u>Consolidated Financial Statements - Audited</u>	<u>75</u>
<u>Consolidated Balance Sheet</u>	<u>75</u>
<u>Consolidated Statement of Income</u>	<u>76</u>
<u>Consolidated Statement of Comprehensive Income</u>	<u>77</u>
<u>Consolidated Statement of Cash Flows</u>	<u>78</u>
<u>Consolidated Statement of Equity</u>	<u>79</u>
<u>Notes to Consolidated Financial Statements</u>	<u>80</u>
<u>Note 1. Operations and Significant Accounting Policies</u>	<u>80</u>
<u>Note 2. Property, Plant and Equipment</u>	<u>91</u>
<u>Note 3. Jointly-Owned Facilities and Projects</u>	<u>92</u>
<u>Note 4. Regulatory Matters</u>	<u>92</u>
<u>Note 5. Investment in ATC</u>	<u>99</u>
<u>Note 6. Acquisitions</u>	<u>100</u>
<u>Note 7. Goodwill and Intangible Assets</u>	<u>105</u>
<u>Note 8. Investments</u>	<u>106</u>
<u>Note 9. Fair Value</u>	<u>106</u>
<u>Note 10. Short-Term and</u>	<u>110</u>

<u>Long-Term Debt</u>	
<u>Note 11.</u>	
<u>Commitments,</u>	<u>112</u>
<u>Guarantees and</u>	
<u>Contingencies</u>	
<u>Note 12.</u>	
<u>Common Stock</u>	<u>120</u>
<u>and Earnings Per</u>	
<u>Share</u>	
<u>Note 13. Income</u>	<u>122</u>
<u>Tax Expense</u>	
<u>Note 14.</u>	
<u>Reclassifications</u>	
<u>Out of</u>	
<u>Accumulated</u>	<u>124</u>
<u>Other</u>	
<u>Comprehensive</u>	
<u>Income (Loss)</u>	
<u>Note 15. Pension</u>	
<u>and Other</u>	<u>125</u>
<u>Postretirement</u>	
<u>Benefit Plans</u>	
<u>Note 16.</u>	
<u>Employee Stock</u>	<u>135</u>
<u>and Incentive</u>	
<u>Plans</u>	
<u>Note 17.</u>	<u>138</u>
<u>Business</u>	
<u>Segments</u>	
<u>Note 18.</u>	
<u>Quarterly</u>	<u>141</u>
<u>Financial Data</u>	
<u>(Unaudited)</u>	
<u>Schedule II</u>	<u>142</u>

ALLETE, Inc. 2017 Form 10-K

3

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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, Inc.
ArcelorMittal	ArcelorMittal USA, Inc.
ASC	Accounting Standards Codification
ATC	American Transmission Company LLC
Basin	Basin Electric Power Cooperative
Bison	Bison Wind Energy Center
BNI Energy	BNI Energy, Inc. and its subsidiary
Boswell	Boswell Energy Center
Camp Ripley	Camp Ripley Solar Array
CIP	Conservation Improvement Program
Cliffs	Cleveland-Cliffs Inc.
CO <sub>2</sub>	Carbon Dioxide
Company	ALLETE, Inc. and its subsidiaries
DC	Direct Current
EIS	Environmental Impact Statement
EITE	Energy-Intensive Trade-Exposed
EPA	United States Environmental Protection Agency
ERP Iron Ore	ERP Iron Ore, LLC
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	Generally Accepted Accounting Principles in the United States of America
GHG	Greenhouse Gases
GNTL	Great Northern Transmission Line
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)
kW / kWh	Kilowatt(s) / Kilowatt-hour(s)
Laskin	Laskin Energy Center
LIBOR	London Interbank Offered Rate
Magnetation	Magnetation, LLC
Manitoba Hydro	Manitoba Hydro-Electric Board
MBtu	Million British thermal units

ALLETE, Inc. 2017 Form 10-K

4

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Definitions (continued)

Abbreviation or Acronym	Term
Mesabi Metallics	Mesabi Metallics Company, 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)
NDPSC	North Dakota Public Service Commission
NERC	North American Electric Reliability Corporation
NOL	Net Operating Loss
NO <sub>2</sub>	Nitrogen Dioxide
NO <sub>x</sub>	Nitrogen Oxides
Northern States Power	Northern States Power Company, a subsidiary of Xcel Energy Inc.
Northshore Mining	Northshore Mining Company, a wholly-owned subsidiary of Cliffs
Note ____	Note ____ to the consolidated financial statements in this Form 10-K
NYSE	New York Stock Exchange
Oliver Wind I	Oliver Wind I Energy Center
Oliver Wind II	Oliver Wind II Energy Center
Palm Coast Park District	Palm Coast Park Community Development District in Florida
PolyMet	PolyMet Mining Corp.
PPA / PSA	Power Purchase Agreement / Power Sales 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
Shell Energy	Shell Energy North America (US), L.P.
Silver Bay Power	Silver Bay Power Company, a wholly-owned subsidiary of Cliffs
SO <sub>2</sub>	Sulfur Dioxide
Square Butte	Square Butte Electric Cooperative, a North Dakota cooperative corporation
Standard & Poor's	S&P Global Ratings
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
Taconite Ridge	Taconite Ridge Energy Center
Tenaska	Tenaska Energy, Inc. and Tenaska Energy Holdings, LLC
Thomson	Thomson Energy Center
TCJA	Tax Cuts and Jobs Act of 2017 (Public Law 115-97)
Tonka Water	Tonka Equipment Company
Town Center District	Town Center at Palm Coast Community Development District in Florida
TransAlta	TransAlta Energy Marketing (U.S.) Inc.
United Taconite	United Taconite LLC, a wholly-owned subsidiary of Cliffs
UPM Blandin	UPM, Blandin paper mill owned by UPM-Kymmene Corporation
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
WTG	Wind Turbine Generator

ALLETE, Inc. 2017 Form 10-K

5

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## 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 cyberattacks;
- 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 GHG;
  - 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 our 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, creditworthiness of customers, ability to obtain materials required to perform services, and changing market conditions.

ALLETE, Inc. 2017 Form 10-K

6

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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 Part 1, Item 1A under the heading “Risk Factors” 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.

ALLETE, Inc. 2017 Form 10-K

7

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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 portions 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 utility 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. (See Note 4. Regulatory Matters.)

ALLETE Clean Energy 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 is contracted under PSAs of various durations. ALLETE Clean Energy also engages in the development of wind energy facilities to operate under long-term PSAs or for sale to others upon completion.

U.S. Water Services provides integrated water management for industry by combining chemical, equipment, engineering and service for customized solutions to reduce water and energy usage, and improve efficiency.

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, 2017, 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	2017	2016	2015 (a)
Consolidated Operating Revenue – Millions	\$1,419.3	\$1,339.7	\$1,486.4

## Percentage of Consolidated Operating Revenue

Regulated Operations	75	%75	%67	%
ALLETE Clean Energy	6	%6	%18	%
U.S. Water Services	11	%10	%8	%
Corporate and Other	8	%9	%7	%
	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.

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 17. Business Segments.



ALLETE, Inc. 2017 Form 10-K

8

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## REGULATED OPERATIONS

## Electric Sales / Customers

## Regulated Utility Kilowatt-hours Sold

Year Ended December 31	2017	%	2016	%	2015	%
Millions						
Retail and Municipal						
Residential	1,096	7	1,102	8	1,113	8
Commercial	1,420	10	1,442	10	1,462	10
Industrial	7,327	50	6,456	45	6,635	46
Municipal	799	5	816	6	833	6
Total Retail and Municipal	10,642	72	9,816	69	10,043	70
Other Power Suppliers	4,039	28	4,316	31	4,310	30
Total Regulated Utility Kilowatt-hours Sold	14,681	100	14,132	100	14,353	100

Industrial Customers. In 2017, industrial customers represented 50 percent of total regulated utility kWh 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	2017	%	2016	%	2015	%
Millions						
Taconite/Iron Concentrate	4,930	67	3,906	61	4,000	60
Paper, Pulp and Secondary Wood Products	1,104	15	1,303	20	1,456	22
Pipelines and Other Industrial	1,293	18	1,247	19	1,179	18
Total Industrial Customer Kilowatt-hours Sold	7,327	100	6,456	100	6,635	100

Six taconite facilities served by Minnesota Power made up approximately 70 percent of 2016 iron ore pellet production in the U.S. according to data from the Minnesota Department of Revenue 2017 Mining Tax Guide. Sales to taconite customers and iron concentrate customers represented 4,930 million kWh, or 67 percent, of total industrial customer kWh sales in 2017. 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's taconite customers are capable of producing up to approximately 41 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 has been 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. These iron concentrate facilities are owned in whole, or in part, by ERP Iron Ore and are currently idled. (See Item 7. Management's Discussion and Analysis – Outlook – Industrial Customers and Prospective Additional Load.)

There has been a general historical correlation between U.S. steel production and Minnesota taconite production. The American Iron and Steel Institute, an association of North American steel producers, reported that U.S. raw steel production operated at approximately 74 percent of capacity in 2017 (71 percent in 2016 and in 2015). The World Steel Association, an association of over 160 steel producers, national and regional steel industry associations, and

steel research institutes representing approximately 85 percent of world steel production, projected U.S. steel consumption in 2018 will increase by approximately 1 percent compared to 2017.

ALLETE, Inc. 2017 Form 10-K

9

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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)
2017*	37
2016	28
2015	31
2014	39
2013	37
2012	39
2011	39
2010	35
2009	17
2008	39

Source: Minnesota

Department of Revenue  
2017 Mining Tax Guide  
for years 2008 - 2016.

\* 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 \$0.04, net of expected power marketing sales at current prices. Changes in wholesale electric prices or customer contractual demand nominations could impact this estimate. Minnesota Power proactively sells power in the wholesale power markets that is temporarily not required by industrial customers to optimize the value of its generating facilities. Long-term reductions in taconite production or a permanent shut down of a taconite customer may lead Minnesota Power to file a general 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 1,104 million kWh, or 15 percent, of total industrial customer kWh sales in 2017. Minnesota Power also has agreements to provide steam for two of its paper and pulp customers for use in the customers' operations. The four major paper and pulp mills we serve reported operating at, or near, full capacity in 2017; however, the smaller of UPM Blandin's two paper machines was closed in the fourth quarter of 2017. (See Item 7. Management's Discussion and Analysis – Outlook – Industrial Customers and Prospective Additional Load.)

**Large Power Customer Contracts.** Minnesota Power has nine Large Power Customer contracts, each serving requirements of 10 MW or more of customer load. The customers consist of six taconite facilities, two iron concentrate reclamation facilities and four paper and pulp mills. Certain facilities have common ownership and are served under combined contracts.

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 kWh used that recovers the variable costs incurred in generating electricity. Five of the Large Power Customer contracts 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.

ALLETE, Inc. 2017 Form 10-K

10

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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 two to four years. Such contracts minimize the impact on earnings that otherwise would result from significant reductions in kWh 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 adjustment clause estimates. Minnesota Power's 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, 2018

Customer	Industry	Location	Ownership	Earliest Termination Date
ArcelorMittal – Minorca Mine	Taconite	Virginia, MN	ArcelorMittal S.A.	December 31, 2025
Hibbing Taconite Co. (a)	Taconite	Hibbing, MN	62.3% ArcelorMittal S.A. 23.0% Cliffs 14.7% USS Corporation	February 28, 2022
United Taconite and Northshore Mining	Taconite	Eveleth, MN and Babbitt, MN	Cliffs	December 31, 2026
USS Corporation (USS – Minnesota Ore) (a)(b)	Taconite	Mt. Iron, MN and Keewatin, MN	USS Corporation	February 28, 2022
Magnetation (c)	Iron Concentrate	Coleraine, MN and Bovey, MN	ERP Iron Ore	December 31, 2025
Boise, Inc.	Paper	International Falls, MN	Packaging Corporation of America	December 31, 2023
UPM Blandin (a)(d)	Paper	Grand Rapids, MN	UPM-Kymmene Corporation	February 28, 2022
NewPage Corporation	Paper and Pulp	Duluth, MN	Verso Corporation	December 31, 2022
Sappi Cloquet LLC (a)	Paper and Pulp	Cloquet, MN	Sappi Limited	February 28, 2022

The contract will terminate four years from the date of written notice from either Minnesota Power or the customer. (a) No notice of contract cancellation has been given by either party. Thus, the earliest date of cancellation is February 28, 2022.

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

(c) On January 30, 2017, ERP Iron Ore, LLC purchased substantially all of Magnetation's assets pursuant to an asset purchase agreement approved by the U.S. Bankruptcy Court for the District of Minnesota. (See Item 7.

Management's Discussion and Analysis – Outlook – Industrial Customers and Prospective Additional Load.)

(d) The smaller of UPM Blandin's two paper machines was closed in the fourth quarter of 2017. (See Item 7. Management's Discussion and Analysis – Outlook – Industrial Customers and Prospective Additional Load.)

Residential and Commercial Customers. In 2017, residential and commercial customers represented 17 percent of total regulated utility kWh sales.

Municipal Customers. In 2017, municipal customers represented 5 percent of total regulated utility kWh sales. All of the municipal contracts include a termination clause requiring a three-year notice to terminate.

ALLETE, Inc. 2017 Form 10-K

11

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REGULATED OPERATIONS (Continued)

Municipal Customers (Continued)

Minnesota Power's wholesale electric contract with the Nashwauk Public Utilities Commission is effective through at least December 31, 2032. No termination notice may be given for this contract prior to July 1, 2029. The wholesale electric service contracts with SWL&P and another municipal customer are effective through at least February 28, 2021, and through June 30, 2019, respectively. Under the agreement with SWL&P, no termination notice has been given. The other municipal customer provided a contract termination notice in June 2016. Minnesota Power currently provides approximately 29 MW of average monthly demand to this customer. The rates included in these three 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. The formula-based rate methodology also provides for a yearly true-up calculation for actual costs incurred.

Minnesota Power's wholesale electric contracts with 14 municipal customers are effective through at least December 31, 2024. No termination notices may be given prior to three years before maturity. These contracts include fixed capacity charges through 2018; beginning in 2019, the capacity charge will be determined using a cost-based formula methodology with limits on the annual change from the previous year's capacity charge. The base energy charge for each year of the contract term will be set each January 1, subject to monthly adjustment, and will also be determined using a cost-based formula methodology.

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

Basin PSA. Minnesota Power has an agreement to sell 100 MW of capacity and energy to Basin for a ten-year period which expires in April 2020. The capacity charge is based on a fixed monthly schedule with a minimum annual escalation provision. The energy charge is based on a fixed monthly schedule and provides for annual escalation based on the cost of fuel. The agreement also allows Minnesota Power to recover a pro rata share of increased costs related to emissions that occur during the last five years of the contract. Minnesota Power has an additional agreement to sell 100 MW of capacity to Basin at fixed rates for a two-year period that began in June 2016.

Minnkota Power PSA. Minnesota Power has a PSA with Minnkota Power where Minnesota Power is selling a portion of its entitlement from Square Butte to Minnkota Power, resulting in Minnkota Power's net entitlement increasing and Minnesota Power's net entitlement decreasing until Minnesota Power's share is eliminated at the end of 2025. Of Minnesota Power's 50 percent output entitlement, it sold approximately 28 percent to Minnkota Power in 2017 (28 percent in 2016 and in 2015). (See Note 11. Commitments, Guarantees and Contingencies.)

Silver Bay Power PSA. In 2016, Minnesota Power and Silver Bay Power entered into a long-term PSA through 2031. Silver Bay Power supplies approximately 90 MW of load to Northshore Mining, an affiliate of Silver Bay Power, which has been served predominately through self-generation by Silver Bay Power. In the years 2016 through 2019, Minnesota Power is supplying Silver Bay Power with at least 50 MW of energy and Silver Bay Power has the option to purchase additional energy from Minnesota Power as it transitions away from self-generation. On December 31, 2019, Silver Bay Power will cease self-generation and Minnesota Power will supply the energy requirements for Silver Bay Power.

Seasonality

The operations of our industrial customers, which make up a large portion of our electric sales, are not typically subject to significant seasonal variations. (See Electric Sales / Customers.) As a result, Minnesota Power is generally not subject to significant seasonal fluctuations in electric sales; however, Minnesota Power and SWL&P electric and



natural gas sales to other customers may be affected by seasonal differences in weather. In general, peak electric sales occur in the winter and summer months with fewer electric sales in the spring and fall months. Peak sales of natural gas generally occur in the winter months. Additionally, our regulated utilities have historically generated fewer sales and less revenue when weather conditions are milder in the winter and summer.

#### Power Supply

In order to meet its customers' electric requirements, Minnesota Power utilizes a mix of its own generation and purchased power. As of December 31, 2017, Minnesota Power's generating capability is primarily coal-fired, but also includes natural gas-fired and biomass co-fired generation, hydroelectric generation, wind energy generation and solar generation. In 2017, Minnesota Power had record hydroelectric and wind energy generation. Purchased power primarily consists of long-term coal, wind and hydro PPAs as well as market purchases. The following table reflects Minnesota Power's generating capabilities as of December 31, 2017, and total electrical supply for 2017. Minnesota Power had an annual net peak load of 1,599 MW on December 27, 2017.

ALLETE, Inc. 2017 Form 10-K

12

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## REGULATED OPERATIONS (Continued)

## Power Supply (Continued)

	Unit	Year	Net	Year Ended	
	No.	Installed	Capability	December 31,	2017
			MW	Generation and	Purchases
				MWh	%
Regulated Utility Power Supply					
Coal-Fired					
Boswell Energy Center	1	1958	67	(a)	
in Cohasset, MN	2	1960	68	(a)	
	3	1973	355		
	4	1980	468	(b)	
			958	6,286,858	41.4
Taconite Harbor Energy Center	1	1957	75		
in Schroeder, MN	2	1957	75		
			150	(c)—	—
Total Coal-Fired			1,108	6,286,858	41.4
Biomass Co-Fired / Natural Gas					
Hibbard Renewable Energy Center in Duluth, MN	3 & 4	1949, 1951	62	4,502	—
Laskin Energy Center in Hoyt Lakes, MN	1 & 2	1953	110	5,615	0.1
Total Biomass Co-Fired / Natural Gas			172	10,117	0.1
Hydro (d)					
Group consisting of ten stations in MN	Multiple	Multiple	120	773,707	5.1
Wind (e)					
Taconite Ridge Energy Center in Mt. Iron, MN	Multiple	2008	25	56,594	0.4
Bison Wind Energy Center in Oliver and Morton Counties, ND	Multiple	2010-2014	497	1,775,474	11.7
Total Wind			522	1,832,068	12.1
Solar					
Camp Ripley Solar Array near Little Falls, MN	Multiple	2016	10	17,129	0.1
Total Generation			1,932	8,919,879	58.8
Long-Term Purchased Power					
Lignite Coal - Square Butte near Center, ND (f)				1,739,781	11.5
Wind - Oliver County, ND				341,785	2.2
Hydro - Manitoba Hydro in Manitoba, Canada				305,532	2.0
Total Long-Term Purchased Power				2,387,098	15.7
Other Purchased Power (g)				3,867,865	25.5
Total Purchased Power				6,254,963	41.2
Total Regulated Utility Power Supply			1,932	15,174,842	100.0

In 2016, Minnesota Power announced that Boswell Units 1 and 2 will be retired in 2018. (See Item 7.

(a) Management's Discussion and Analysis of Financial Condition and Results of Operations – Outlook – EnergyForward.)

(b) Boswell Unit 4 net capability shown above reflects Minnesota Power's ownership percentage of 80 percent. WPPI Energy owns 20 percent of Boswell Unit 4. (See Note 3. Jointly-Owned Facilities and Projects.)

(c) Taconite Harbor Units 1 and 2 were idled in 2016. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Outlook – EnergyForward.)

(d) Hydro consists of 10 stations with 34 generating units.

(e) Taconite Ridge consists of 10 WTGs and Bison consists of 165 WTGs.

- (f) Minnesota Power has a PSA with Minnkota Power whereby Minnesota Power is selling a portion of its entitlement from Square Butte to Minnkota Power. (See Electric Sales / Customers.)
- (g) Includes short-term market purchases in the MISO market and from Other Power Suppliers.

ALLETE, Inc. 2017 Form 10-K

13

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## REGULATED OPERATIONS (Continued)

## Power Supply (Continued)

Fuel. Minnesota Power purchases low-sulfur, sub-bituminous coal from the Powder River Basin region located in Montana and Wyoming. Coal consumption in 2017 for electric generation at Minnesota Power's coal-fired generating stations was 3.8 million tons (4.2 million tons in 2016; 4.4 million tons in 2015). As of December 31, 2017, Minnesota Power had coal inventories of 1.2 million tons (1.4 million tons as of December 31, 2016). Minnesota Power has coal supply agreements providing for the purchase of a significant portion of its coal requirements through December 2018 and a portion of its coal requirements through December 2021. In 2018, Minnesota Power expects to obtain coal under these coal supply agreements and in the spot market. Minnesota Power continues to explore other future coal supply options and believes that adequate supplies of low-sulfur, sub bituminous coal will continue to be available.

Minnesota Power also has coal transportation agreements in place for the delivery of a significant portion of its coal requirements through December 2018. The costs of fuel and related transportation costs for Minnesota Power's generation are recoverable from Minnesota Power's utility customers through the fuel adjustment clause.

## Coal Delivered to Minnesota Power

Year Ended December 31	2017	2016	2015
Average Price per Ton	\$36.50	\$35.87	\$27.00
Average Price per MBtu	\$2.01	\$1.98	\$1.49

Long-Term Purchased Power. Minnesota Power has contracts to purchase capacity and energy from various entities, including output from certain coal, wind, hydro and solar generating facilities.

Our PPAs are detailed in Note 11. Commitments, Guarantees and Contingencies, with additional disclosure provided in the following paragraph.

Square Butte PPA. Under the PPA with Square Butte that extends through 2026, Minnesota Power is entitled to 50 percent of the output of Square Butte's 455 MW coal-fired generating unit. (See Note 11. Commitments, Guarantees and Contingencies.) BNI Energy mines and sells lignite coal to Square Butte. This lignite supply is sufficient to provide fuel for the anticipated useful life of the generating unit. Square Butte's cost of lignite consumed in 2017 was approximately \$1.71 per MBtu (\$1.57 per MBtu in 2016; \$1.55 per MBtu in 2015). (See Electric Sales / Customers – Minnkota Power PSA.)

## Transmission and Distribution

We have electric transmission and distribution lines of 500 kV (8 miles), 345 kV (242 miles), 250 kV (466 miles), 230 kV (717 miles), 161 kV (43 miles), 138 kV (190 miles), 115 kV (1,280 miles) and less than 115 kV (6,334 miles). We own and operate 167 substations with a total capacity of 8,540 megavoltamperes. Some of our transmission and distribution lines interconnect with other utilities.

CapX2020. Minnesota Power was a participant in the CapX2020 initiative which represented an effort to ensure electric transmission and distribution reliability in Minnesota and the surrounding region for the future. CapX2020, which consisted of electric cooperatives and municipal and investor-owned utilities, including Minnesota's largest transmission owners, assessed the transmission system and projected growth in customer demand for electricity through 2020. Minnesota Power participated in three CapX2020 projects which were completed and placed in service in 2011, 2012 and 2015.

Great Northern Transmission Line. As a condition of the 250 MW long-term PPA entered into with Manitoba Hydro, construction of additional transmission capacity is required. As a result, Minnesota Power and Manitoba Hydro proposed construction of the GNTL, an approximately 220-mile 500-kV transmission line between Manitoba and Minnesota's Iron Range in order to strengthen the electric grid, enhance regional reliability and promote a greater exchange of sustainable energy.

ALLETE, Inc. 2017 Form 10-K

14

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REGULATED OPERATIONS (Continued)

Transmission and Distribution (Continued)

In 2015, a certificate of need was approved by the MPUC. Based on this approval, Minnesota Power's portion of the investments and expenditures for the project are eligible for cost recovery under its existing transmission cost recovery rider and are anticipated to be included in future transmission cost recovery filings. (See Note 4. Regulatory Matters.) Also in 2015, the FERC approved our request to recover on construction work in progress related to the GNTL from Minnesota Power's wholesale customers. In an April 2016 order, the MPUC approved the route permit for the GNTL which largely follows Minnesota Power's preferred route, including the international border crossing, and in November 2016, the U.S. Department of Energy issued a presidential permit to cross the U.S.-Canadian border, which was the final major regulatory approval needed before construction in the U.S. could begin. Site clearing and pre-construction activities commenced in the first quarter of 2017 with construction expected to be completed in 2020. Total project cost in the U.S., including substation work, is estimated to be between \$560 million and \$710 million, of which Minnesota Power's portion is expected to be between \$300 million and \$350 million; the difference will be recovered from a subsidiary of Manitoba Hydro as contributions in aid of construction. Total project costs of \$152.4 million have been incurred through December 31, 2017, of which \$67.6 million has been recovered from a subsidiary of Manitoba Hydro.

Manitoba Hydro must obtain regulatory and governmental approvals related to a new transmission line in Canada. In 2015, Manitoba Hydro submitted the final preferred route and EIS for the transmission line in Canada to the Manitoba Conservation and Water Stewardship for regulatory approval. In December 2016, Manitoba Hydro filed an application with the National Energy Board in Canada requesting authorization to construct and operate an international transmission line. Both provincial and federal approvals are pending. Construction of Manitoba Hydro's hydroelectric generation facility commenced in 2014 and is anticipated to be in service by early 2021.

Investment in ATC

Our wholly-owned subsidiary, ALLETE Transmission Holdings, owns approximately 8 percent of ATC, a Wisconsin-based utility that owns and maintains electric transmission assets in portions of Wisconsin, Michigan, Minnesota and Illinois. We account for our investment in ATC under the equity method of accounting. As of December 31, 2017, our equity investment in ATC was \$118.7 million (\$135.6 million as of December 31, 2016). The decrease in our equity investment in ATC in 2017 is due to the impact of the remeasurement of deferred income tax assets and liabilities resulting from the TCJA. (See Note 1. Operations and Significant Accounting Policies, and Note 5. Investment in ATC.)

In September 2016, the FERC issued an order reducing ATC's authorized return on equity to 10.32 percent, or 10.82 percent including an incentive adder for participation in a regional transmission organization. Prior to this order, ATC had been allowed a return on equity of 12.2 percent which had been impacted by reductions for estimated refunds related to complaints filed with the FERC by several customers located within the MISO service area.

In June 2016, a federal administrative law judge ruled on an additional complaint proposing a further reduction in the base return on equity to 9.70 percent, or 10.20 percent including an incentive adder for participation in a regional transmission organization, subject to approval or adjustment by the FERC. A final decision from the FERC on the administrative law judge's recommendation is pending. (See Note 4. Regulatory Matters.)

ATC's 10-year transmission assessment, which covers the years 2017 through 2026, identifies a need for between \$2.8 billion and \$3.6 billion in transmission system investments. These investments by ATC, if undertaken, are expected to be funded through a combination of internally generated cash, debt and investor contributions. As opportunities arise, we plan to make additional investments in ATC through general capital calls based upon our pro rata ownership

interest in ATC.

#### Properties

Our Regulated Operations businesses own office and service buildings, an energy control center, repair shops, electric plants, transmission facilities and storerooms in various localities in Minnesota, Wisconsin and North Dakota. All of the electric plants are subject to mortgages, which collateralize the outstanding first mortgage bonds of Minnesota Power and SWL&P. Most of the generating plants and substations are located on real property owned by Minnesota Power or SWL&P, subject to the lien of a mortgage, whereas most of the electric lines are located on real property owned by others with appropriate easement rights or 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 3. Jointly-Owned Facilities and Projects.)

ALLETE, Inc. 2017 Form 10-K

15

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REGULATED OPERATIONS (Continued)

Regulatory Matters

We are subject to the jurisdiction of various regulatory authorities and other organizations.

**Electric Rates.** All rates and contract terms in our Regulated Operations are subject to approval by applicable regulatory authorities. Minnesota Power and SWL&P design their retail electric service rates based on cost of service studies under which allocations are made to the various classes of customers as approved by the MPUC or the PSCW. Nearly all retail sales include billing adjustment clauses, which may 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 transmission, renewable and environmental investments.

**Minnesota Public Utilities Commission.** The MPUC has regulatory authority over Minnesota Power's retail service area in Minnesota, retail rates, retail services, capital structure, issuance of securities and other matters. As authorized by the MPUC, Minnesota Power also recognizes revenue under cost recovery riders for transmission, renewable and environmental investments.

**2016 Minnesota General Rate Case.** In November 2016, Minnesota Power filed a retail rate increase request with the MPUC seeking an average increase of approximately 9 percent for retail customers. The rate filing sought a return on equity of 10.25 percent and a 53.81 percent equity ratio. On an annualized basis, the requested final rate increase would have generated approximately \$55 million in additional revenue. In December 2016, Minnesota Power filed a request to modify its original interim rate proposal reducing its requested interim rate increase to \$34.7 million from the original request of approximately \$49 million due to a change in its electric sales forecast. In December 2016 orders, the MPUC accepted the November 2016 filing as complete and authorized an annual interim rate increase of \$34.7 million beginning January 1, 2017.

On February 23, 2017, Minnesota Power filed an additional request to further reduce its requested interim rate increase. In an order dated April 13, 2017, the MPUC approved Minnesota Power's updated retail rate request resulting in a reduction in the annual interim rate increase to \$32.2 million beginning May 1, 2017. As a result of working with intervenors and further developments as the rate review progressed, Minnesota Power's final rate request was adjusted to approximately \$49 million on an annualized basis. At a hearing on January 18, 2018, the MPUC made determinations regarding Minnesota Power's general rate case including allowing a return on common equity of 9.25 percent and a 53.81 percent equity ratio. Upon commencement of final rates, we expect additional revenue of approximately \$13 million on an annualized basis. Final rates are expected to commence in the fourth quarter of 2018; interim rates will be collected through this period which will be fully offset by the recognition of a corresponding reserve. As a result of the MPUC's decisions on January 18, 2018, Minnesota Power has recorded a reserve for an interim rate refund of approximately \$32 million as of December 31, 2017. The MPUC also disallowed recovery of Minnesota Power's regulatory asset for deferred fuel adjustment clause costs due to the anticipated adoption of a forward-looking fuel adjustment clause methodology resulting in a \$19.5 million pre-tax charge to Fuel, Purchased Power and Gas – Utility in 2017. An order from the MPUC setting forth the effective date of final rates is expected by March 12, 2018. Minnesota Power will review this order for potential reconsideration of certain issues at that time.

As part of its decision in Minnesota Power's 2016 general rate case, the MPUC extended the depreciable lives of Boswell Unit 3, Unit 4 and common facilities to 2050 primarily to mitigate rate increases for our customers, and shortened the depreciable lives of Boswell Unit 1 and Unit 2 to 2022, resulting in a decrease to depreciation expense of approximately \$25 million pre-tax in 2017.





REGULATED OPERATIONS (Continued)

Regulatory Matters (Continued)

Energy-Intensive Trade-Exposed Customer Rates. An EITE customer ratemaking law was enacted in 2015 which established that it is the energy policy of Minnesota to have competitive rates for certain industries such as mining and forest products. In 2015, Minnesota Power filed a rate schedule petition with the MPUC for EITE customers and a corresponding rider for EITE cost recovery. In a March 2016 order, the MPUC dismissed the petition without prejudice. In June 2016, Minnesota Power filed a revised EITE petition with the MPUC which included additional information on the net benefits analysis, limits on eligible customers and term lengths for the EITE discount. The rate adjustments were intended to be revenue and cash flow neutral to Minnesota Power. The MPUC approved a reduction in rates for EITE customers in a December 2016 order and subsequently approved cost recovery in an order dated April 20, 2017; collection of the discount was subject to the MPUC's review of Minnesota Power's compliance filing implementing approval of a recovery mechanism, with the subsequent order issued on October 13, 2017, that modified the order dated April 20, 2017. During 2017, Minnesota Power provided discounts of \$8.6 million which were recorded as a receivable. On September 29, 2017, Minnesota Power informed its EITE customers that it had suspended the EITE discount due to a concern that it was not revenue and cash flow neutral to Minnesota Power based on an MPUC decision at a hearing on September 7, 2017, as well as the interim rate reduction and decisions in its 2016 general rate case. Based on the MPUC's decisions at a hearing on January 18, 2018, as part of Minnesota Power's 2016 general rate case, Minnesota Power reinstated the EITE discount effective January 1, 2018. Minnesota Power expects the discount to EITE customers to be approximately \$15 million annually based on EITE customer current operating levels. While interim rates are in effect for Minnesota Power's 2016 general rate case, EITE discounts will offset interim rate refund reserves for non-EITE customers.

Additional regulatory proceedings pending with the MPUC are detailed in Note 4. Regulatory Matters.

Public Service Commission of Wisconsin. The PSCW has regulatory authority over SWL&P's retail sales of electricity, natural gas and water, issuances of securities and other matters.

2016 Wisconsin General Rate Case. SWL&P's current retail rates are based on a 2017 PSCW retail rate order effective August 14, 2017, that allows for a 10.5 percent return on common equity and a 55 percent equity ratio. SWL&P's retail rates prior to August 14, 2017, were based on a 2012 PSCW retail rate order that provided for a 10.9 percent return on equity. The 2017 PSCW retail rate order authorizes SWL&P to collect on average a 2.9 percent increase in rates for retail customers (3.8 percent increase in electric rates; 4.8 percent decrease in natural gas rates; and 9.8 percent increase in water rates). On an annualized basis, SWL&P expects to collect additional revenue of \$2.5 million.

Federal Energy Regulatory Commission. The FERC has jurisdiction over the licensing of hydroelectric projects, the establishment of rates and charges for transmission of electricity in interstate commerce, electricity sold at wholesale (including the rates for Minnesota Power's municipal and wholesale customers), natural gas transportation, certain accounting and record keeping practices, certain activities of our regulated utilities and the operations of ATC. FERC jurisdiction also includes enforcement of NERC mandatory electric reliability standards. Violations of FERC rules are subject to enforcement action by the FERC including financial penalties up to \$1 million per day per violation. Regulatory proceedings pending with the FERC are detailed in Note 4. Regulatory Matters.

North Dakota Public Service Commission. The NDPSC has jurisdiction over site and route permitting of generation and transmission facilities in North Dakota.

Regional Organizations

Midcontinent Independent System Operator, Inc. Minnesota Power, SWL&P and ATC are members of MISO, a regional transmission organization. While Minnesota Power and SWL&P retain ownership of their respective transmission assets, their transmission networks are under the regional operational control of MISO. Minnesota Power and SWL&P take and provide transmission service under the MISO open access transmission tariff. MISO continues its efforts to oversee the safe, cost-effective delivery of electric power across all or parts of 15 states and the Canadian province of Manitoba which includes nearly 176,000 MW of generating capacity.

North American Electric Reliability Corporation. The NERC has been certified by the FERC as the national electric reliability organization. The NERC ensures the reliability of the North American bulk power system. The NERC oversees eight regional entities that establish requirements, approved by the FERC, for reliable operation and maintenance of power generation facilities and transmission systems. Minnesota Power is subject to these reliability requirements and can incur significant penalties for non compliance.

ALLETE, Inc. 2017 Form 10-K

17

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## REGULATED OPERATIONS (Continued)

### Regional Organizations (Continued)

Midwest Reliability Organization (MRO). Minnesota Power and ATC are members of the MRO, one of the eight regional entities overseen by the NERC. The MRO's primary responsibilities are to: ensure compliance with mandatory reliability standards by entities who own, operate or use the interconnected, international bulk power system; conduct assessments of the grid's ability to meet electricity demand in the region; and analyze regional system events.

The MRO region spans the Canadian provinces of Saskatchewan and Manitoba, and all or parts of the states of Illinois, Iowa, Minnesota, Michigan, Montana, Nebraska, North Dakota, South Dakota and Wisconsin. The region includes more than 130 organizations that are involved in the production and delivery of electricity to more than 20 million people. These organizations include municipal utilities, cooperatives, investor-owned utilities, transmission system operators, a federal power marketing agency, Canadian Crown corporations and independent power producers.

### Minnesota Legislation

Renewable Energy. Minnesota law requires 25 percent of electric utilities' applicable retail and municipal energy sales in Minnesota to be from renewable energy sources by 2025. Minnesota 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 meeting a milestone if implementation will cause significant ratepayer cost or technical reliability issues. If a utility is not in compliance with a milestone, the MPUC may order the utility to construct facilities, purchase renewable energy or purchase renewable energy credits. Minnesota Power's 2015 IRP, which was filed with the MPUC in 2015 and approved with modifications by the MPUC in a July 2016 order, includes an update on its plans and progress in meeting the Minnesota renewable energy milestones through 2025. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Outlook – EnergyForward.)

Minnesota Power continues to execute its renewable energy strategy through renewable projects that will ensure it meets the identified state mandate at the lowest cost for customers. Minnesota Power has exceeded the interim milestone requirements to date with approximately 31 percent of its applicable retail and municipal energy sales supplied by renewable energy sources in 2017.

Minnesota Solar Energy Standard. Minnesota law requires at least 1.5 percent of total retail electric sales, excluding sales to certain customers, to be generated by solar energy by the end of 2020. At least 10 percent of the 1.5 percent mandate must be met by solar energy generated by or procured from solar photovoltaic devices with a nameplate capacity of 40 kW or less and community solar garden subscriptions. In a 2016 order, the MPUC approved Camp Ripley, a 10 MW utility scale solar project at the Camp Ripley Minnesota Army National Guard base and training facility near Little Falls, Minnesota, as eligible to meet the solar energy standard and for current cost recovery. Camp Ripley was completed in the fourth quarter of 2016. In a July 2016 order, the MPUC approved a community solar garden project in northeastern Minnesota, which is comprised of a 1 MW solar array owned and operated by a third party with the output purchased by Minnesota Power and a 40 kW solar array that is owned and operated by Minnesota Power. Minnesota Power believes Camp Ripley and the community solar garden arrays will meet approximately one-third of the overall mandate. Additionally, in an order dated February 10, 2017, the MPUC approved Minnesota Power's proposal to increase the amount of solar rebates available for customer-sited solar installations and recover costs of the program through Minnesota Power's renewable cost recovery rider. The proposal to incentivize customer-sited solar installations and the community solar garden subscriptions is expected to meet a portion of the required small scale solar mandate.

### Competition

Retail electric energy sales in Minnesota and Wisconsin are made to customers in assigned service territories. As a result, most retail electric customers in Minnesota do not have the ability to choose their electric supplier. Large energy users of 2 MW and above that are located outside of a municipality are allowed to choose a supplier upon MPUC approval. Minnesota Power serves 12 Large Power facilities over 10 MW, none of which have engaged in a competitive rate process. No other large commercial or small industrial customers in Minnesota Power's service territory have sought a provider outside Minnesota Power's service territory since 1994. Retail electric and natural gas customers in Wisconsin do not have the ability to choose their energy supplier. In both states, however, electricity may compete with other forms of energy. Customers may also choose to generate their own electricity, or substitute other forms of energy for their manufacturing processes.

ALLETE, Inc. 2017 Form 10-K

18

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## REGULATED OPERATIONS (Continued)

### Competition (Continued)

In 2017, 5 percent of total regulated utility kWh sales were to municipal customers in Minnesota by contract. These customers have the right to seek an energy supply from any wholesale electric service provider upon contract expiration. Minnesota Power's wholesale electric contract with the Nashwauk Public Utilities Commission is effective through at least December 31, 2032. Minnesota Power wholesale electric contracts with 14 municipal customers are effective through at least December 31, 2024. In June 2016, one of Minnesota Power's municipal customers provided a contract termination notice effective June 30, 2019. (See Electric Sales / Customers.)

The FERC has continued with its efforts to promote a more competitive wholesale market through open-access electric transmission and other means. As a result, our electric sales to Other Power Suppliers and our purchases to supply our retail and wholesale load are made in the competitive market.

### Franchises

Minnesota Power holds franchises to construct and maintain an electric distribution and transmission system in 91 cities. The remaining cities, villages and towns served by Minnesota Power do not require a franchise to operate. SWL&P serves customers under electric, natural gas or water franchises in 1 city and 14 villages or towns.

## ENERGY INFRASTRUCTURE AND RELATED SERVICES

### ALLETE Clean Energy

ALLETE Clean Energy 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 is contracted under PSAs of various durations. ALLETE Clean Energy also engages in the development of wind energy facilities to operate under long-term PSAs or for sale to others upon completion.

ALLETE Clean Energy believes the market for renewable energy in North America is robust, driven by several factors including environmental regulation, tax incentives, societal expectations and continual technology advances. State renewable portfolio standards, and state or federal regulations to limit GHG emissions are examples of environmental regulation or public policy that we believe will drive renewable energy development.

ALLETE Clean Energy's strategy includes the safe, reliable, optimal and profitable operation of its existing facilities. This includes a strong safety culture, the continuous pursuit of operational efficiencies at existing facilities and cost controls. ALLETE Clean Energy generally acquires facilities in liquid power markets and its strategy includes the exploration of PSA extensions upon expiration of existing contracts.

ALLETE Clean Energy will pursue growth through acquisitions or project development for others. ALLETE Clean Energy is targeting acquisitions of existing facilities up to 200 MW each, which have long-term PSAs in place for the facilities' output. At this time, ALLETE Clean Energy expects acquisitions will be primarily wind or solar facilities in North America. ALLETE Clean Energy is also targeting the development of new facilities up to 200 MW each, which will have long-term PSAs in place for the output or may be sold upon completion.

Federal production tax credit qualification is important to development project economics, and ALLETE Clean Energy invested in equipment in late 2016 and late 2017 to meet production tax credit safe harbor provisions which provides an opportunity to seek development of up to approximately 1,500 MW of qualified wind projects through

2021. ALLETE Clean Energy will also invest approximately \$80 million through 2020 to requalify up to 385 WTGs at its Storm Lake I, Storm Lake II and Lake Benton wind energy facilities for production tax credits.

ALLETE, Inc. 2017 Form 10-K

19

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## ENERGY INFRASTRUCTURE AND RELATED SERVICES (Continued)

## ALLETE Clean Energy (Continued)

On January 3, 2017, ALLETE Clean Energy announced that it will develop a wind energy facility of up to 50 MW after securing a 25-year PSA with Montana-Dakota Utilities, which includes an option to purchase the facility upon completion. We expect Montana-Dakota Utilities to exercise the option in the first quarter of 2018; construction and sale is expected to be completed in December 2018. ALLETE Clean Energy constructed and sold a 107 MW wind energy facility to Montana-Dakota Utilities in 2015. On March 16, 2017, ALLETE Clean Energy announced it will build, own and operate a separate 100 MW wind energy facility pursuant to a 20-year PSA with Northern States Power; construction is expected to begin in late 2018.

ALLETE Clean Energy manages risk by having a diverse portfolio of assets, which includes PSA expiration, technology and geographic diversity. The current portfolio of approximately 535 MW is subject to typical variations in seasonal wind with higher wind resources typically available in the winter months. The majority of its planned maintenance leverages this seasonality and is performed during lower wind periods. The current mix of PSA expiration and geographic location for existing facilities is as follows:

Wind Energy Facility	Location	Capacity MW	PSA MW	PSA Expiration
Armenia Mountain	Pennsylvania	100.5	100%	2024
Chanarambie/Viking	Minnesota	97.5		
PSA 1			12%	2018
PSA 2			88%	2023
Condon	Oregon	50	100%	2022
Lake Benton	Minnesota	104	100%	2028
Storm Lake I	Iowa	108	100%	2019
Storm Lake II	Iowa	77		
PSA 1			90%	2019
PSA 2			10%	2032

The majority of ALLETE Clean Energy's wind operations are located on real property owned by others with appropriate easements rights or necessary consents of governmental authorities. Two of ALLETE Clean Energy's wind energy facilities are encumbered by liens against their assets securing financing.

## U.S. Water Services

U.S. Water Services provides integrated water management for industry by combining chemical, equipment, engineering and service for customized solutions to reduce water and energy usage, and improve efficiency. U.S. Water Services is located in 49 states and Canada and has an established base of approximately 4,900 customers. U.S. Water Services differentiates itself from the competition by developing synergies between established solutions in engineering, equipment and chemical water treatment, and helping customers achieve efficient and sustainable use of their water and energy systems. U.S. Water Services is a leading provider to the biofuels industry, and also serves the commercial and institutional markets, food and beverage, light manufacturing, power generation, and midstream oil and gas industries, among others. U.S. Water Services principally relies upon recurring revenues from a diverse mix of industrial customers. U.S. Water Services sells certain products which are seasonal in nature, with higher demand typically realized in warmer months; generally, lower sales occur in the first quarter of each year.

Our strategy is to grow U.S. Water Services' presence in North America by adding customers, products, markets and new geographies. We believe water scarcity and a growing emphasis on conservation will continue to drive significant growth in the industrial, commercial and governmental sectors leading to organic revenue growth for U.S. Water Services. U.S. Water Services also expects to pursue periodic strategic tuck-in acquisitions with a purchase price in



the \$10 million to \$50 million range. Priority will be given to acquisitions which expand its geographic reach, add new technology or deepen its capabilities to serve its expanding customer base.

On September 1, 2017, U.S. Water Services acquired Tonka Water for total consideration of \$19.2 million. Tonka Water is a supplier of municipal and industrial water treatment systems that will expand U.S. Water Services' geographic and customer markets.

U.S. Water Services leases an office and production facility at its headquarters in Minnesota as well as various office, warehouse and production facilities across the United States.

ALLETE, Inc. 2017 Form 10-K

20

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## CORPORATE AND OTHER

## BNI Energy

BNI Energy is a supplier of lignite coal in North Dakota, producing approximately 4 million tons annually and has an estimated 650 million tons of lignite coal reserves. Two electric generating cooperatives, Minnkota Power and Square Butte, consume virtually all of BNI Energy's production of lignite under cost-plus fixed fee coal supply agreements extending through December 31, 2037. (See Item 1. Business – Regulated Operations – Power Supply – Long-Term Purchased Power and Note 11. 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. As of December 31, 2017, BNI Energy had a \$25.0 million asset reclamation obligation (\$23.5 million as of December 31, 2016) included in Other Non-Current Liabilities on the Consolidated Balance Sheet. These costs are included in the cost-plus fixed fee contract, for which an asset reclamation cost receivable was included in Other Non-Current Assets on the Consolidated Balance Sheet. The asset reclamation obligation is guaranteed by surety bonds and a letter of credit. (See Note 11. Commitments, Guarantees and Contingencies.)

## ALLETE Properties

ALLETE Properties represents our legacy Florida real estate investment. Market conditions can impact land sales and could result in our inability to cover our cost basis, operating expenses or fixed carrying costs such as community development district assessments and property taxes.

ALLETE Properties' major projects in Florida are Town Center at Palm Coast and Palm Coast Park.

Summary of Projects As of December 31, 2017	Acres (a)	Residential Non-residential	
		Units (b)	Sq. Ft. (b)(c)
Projects			
Town Center at Palm Coast	971	2,419	2,178,700
Palm Coast Park	1,025	830	2,143,000
Total Projects	1,996	3,249	4,321,700

(a) Acreage amounts are approximate and shown on a gross basis, including wetlands.

(b) Units and square footage are estimated. Density at build out may differ from these estimates.

(c) Includes retail and non-retail commercial, office, industrial, warehouse, storage and institutional square footage.

In addition to the two projects, ALLETE Properties has approximately 800 acres of other land available for sale.

In recent years, market conditions for real estate in Florida have required us to review our land inventories for impairment. In 2015, the Company reevaluated its strategy related to the real estate assets of ALLETE Properties in response to market conditions and transaction activity. The revised strategy incorporated the possibility of a bulk sale of its entire portfolio. Proceeds from a bulk sale would be strategically deployed to support growth in ALLETE Clean Energy and U.S. Water Services, collectively our Energy Infrastructure and Related Services businesses. ALLETE Properties also continues to pursue sales of individual parcels over time. ALLETE Properties will continue to maintain key entitlements and infrastructure without making additional investments or acquisitions.

In connection with implementing the revised strategy, management evaluated its impairment analysis for its real estate assets using updated assumptions to determine estimated future net cash flows on an undiscounted basis. Estimated fair values were based upon current market data and pricing for individual parcels. Our impairment analysis incorporates a probability-weighted approach considering the alternative courses of sales noted above.

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Based on the results of the 2015 undiscounted cash flow analysis, the undiscounted future net cash flows were not adequate to recover the carrying value of the real estate assets leading to an adjustment of carrying value to estimated fair value. Estimated fair value was derived using Level 3 inputs, including current market interest in the property for a bulk sale of its entire portfolio, and discounted cash flow analysis of estimated selling price for sales over time. As a result, a non-cash impairment charge of \$36.3 million was recorded in 2015 to reduce the carrying value of the real estate to its estimated fair value.

In 2017 and 2016, our qualitative assessments indicated that the cash flows were adequate to recover the carrying value of ALLETE Properties real estate assets. As a result, no impairment was recorded in 2017 or 2016.

ALLETE, Inc. 2017 Form 10-K

21

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## CORPORATE AND OTHER (Continued)

## ALLETE Properties (Continued)

**Seller Financing.** ALLETE Properties occasionally provides seller financing to certain qualified buyers. As of December 31, 2017, outstanding finance receivables were \$15.5 million, net of reserves, with maturities through 2022. 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.

## Non-Rate Base Generation and Miscellaneous

Corporate and Other also includes 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.

As of December 31, 2017, non-rate base generation consists of 29 MW of generation at Rapids Energy Center. In 2017, we sold 0.1 million MWh of non-rate base generation (0.1 million MWh in 2016 and in 2015).

Non-Rate Base Power Supply	Unit No.	Year Installed	Year Acquired	Net Capability (MW)
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Rapids Energy Center (a)

in Grand Rapids, MN

Steam – Biomass (b)	6 & 7	1969, 1980	2000	27
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Hydro	4 & 5	1917, 1948	2000	2
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The net generation is primarily dedicated to the needs of one customer, UPM Blandin in Grand Rapids, Minnesota. (a) (See Item 7. Management's Discussion and Analysis – Outlook – Industrial Customers and Prospective Additional Load.)

(b) Rapids Energy Center's fuel supply is supplemented by coal.

## ENVIRONMENTAL MATTERS

Our businesses are subject to regulation of environmental matters by various federal, state and local authorities. A number of regulatory changes to the Clean Air Act, the Clean Water Act and various waste management requirements have recently been promulgated by both the EPA and state authorities. Minnesota Power's facilities are subject to additional requirements under many of these regulations. Minnesota Power is reshaping its generation portfolio, over time, to reduce its reliance on coal, has installed cost-effective emission control technology, and advocates for sound science and policy during rulemaking implementation.

We consider our businesses to be in substantial compliance with currently applicable environmental regulations and believe all necessary permits have been obtained. We anticipate that with many state and federal environmental regulations finalized, or to be finalized in the near future, potential expenditures for future environmental matters may be material and may require significant capital investments. Minnesota Power has evaluated various environmental compliance scenarios using possible outcomes of environmental regulations to project power supply trends and impacts on customers.

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We review environmental matters 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. Accruals are adjusted as assessment and remediation efforts progress or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the Consolidated 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 expensed unless recoverable in rates from customers. (See Note 11. Commitments, Guarantees and Contingencies.)

ALLETE, Inc. 2017 Form 10-K

22

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## EMPLOYEES

As of December 31, 2017, ALLETE had 2,017 employees, of which 1,972 were full-time.

Minnesota Power and SWL&P have an aggregate of 517 employees who are members of the International Brotherhood of Electrical Workers (IBEW) Local 31. The labor agreements with IBEW Local 31 expired on January 31, 2018. Negotiations are proceeding and we believe ratified agreements will be agreed upon in the first quarter of 2018. Minnesota Power, SWL&P and IBEW Local 31 are operating under the expired labor agreements until new contracts are agreed upon.

BNI Energy has 179 employees, of which 136 are members of IBEW Local 1593. The labor agreement with IBEW Local 1593 expires on March 31, 2019.

## AVAILABILITY OF INFORMATION

ALLETE makes its SEC filings, including its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(e) or 15(d) of the Securities Exchange Act of 1934, available free of charge on ALLETE's website, [www.allete.com](http://www.allete.com), as soon as reasonably practicable after they are electronically filed with or furnished to the SEC.

ALLETE, Inc. 2017 Form 10-K

23

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EXECUTIVE OFFICERS OF THE REGISTRANT

As of February 15, 2018, these are the executive officers of ALLETE:

Executive Officers	Initial Effective Date
Alan R. Hodnik, Age 58 Chairman, President and Chief Executive Officer President and Chief Executive Officer	May 10, 2011 May 1, 2010
Robert J. Adams, Age 55 Senior Vice President and Chief Financial Officer Senior Vice President – Energy-Centric Businesses and Chief Risk Officer Vice President – Energy-Centric Businesses and Chief Risk Officer Vice President – Business Development and Chief Risk Officer	March 4, 2017 November 14, 2015 June 23, 2014 May 13, 2008
Deborah A. Amberg, Age 52 Senior Vice President, Chief Strategy Officer – Regulated Operations and President – SWL&P Senior Vice President, General Counsel and Secretary	November 26, 2016 January 1, 2006
Patrick L. Cutshall, Age 52 Vice President and Corporate Treasurer Treasurer	December 18, 2017 January 1, 2016
Steven W. Morris, Age 56 Vice President, Controller and Chief Accounting Officer Controller	December 24, 2016 March 3, 2014
Patrick K. Mullen, Age 57 Senior Vice President – External Affairs	April 10, 2017
Bradley W. Oachs, Age 60 Senior Vice President and President – Regulated Operations	November 26, 2016
Bethany M. Owen, Age 52 Senior Vice President and Chief Legal and Administrative Officer	November 26, 2016

All of the executive officers have been employed by us for more than five years in executive or management positions. Prior to election to the position listed above, the following executives held other positions with the Company during the past five years.

Mr. Morris was Director – Accounting.

Mr. Cutshall was Director – Investments and Tax; Director – Investments.

Mr. Oachs was Chief Operating Officer – Minnesota Power.

Ms. Owen was Vice President – Information Technology Solutions and President – SWL&P.

Mr. Mullen was Vice President – Marketing and Corporate Communications.

There are no family relationships between any of the executive officers. All officers and directors are elected or appointed annually.

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The present term of office of the executive officers listed in the preceding table extends to the first meeting of our Board of Directors after the next annual meeting of shareholders. Both meetings are scheduled for May 8, 2018.

ALLETE, Inc. 2017 Form 10-K

24

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## Item 1A. Risk Factors

The risks and uncertainties discussed below could materially affect our business operations, financial position, results of operations and cash flows, and should be carefully considered by stakeholders. The risks and uncertainties in this section are not the only ones we face; additional risks and uncertainties that we are not presently aware of, or that we currently consider immaterial, may also affect our business operations, financial position, results of operations and cash flows. Accordingly, the risks described below should be carefully considered together with other information set forth in this report and in future reports that we file with the SEC.

### Entity-wide Risks

We rely on access to financing sources and capital markets. If we do not have access to capital on acceptable terms or are unable to obtain capital when needed, our ability to execute our business plans, make capital expenditures or pursue other strategic actions that we may otherwise rely on for future growth would be adversely affected.

We rely on access to financing sources and the capital markets, on acceptable terms and at reasonable costs, as sources of liquidity for capital requirements not satisfied by our cash flows from operations. Market disruptions or a downgrade of our credit ratings may increase the cost of borrowing or adversely affect our ability to access and financing costs in the capital markets. Such disruptions or causes of a downgrade could include but are not limited to: the effects of the TCJA on the Company's cash flow metrics; a loss of, or a reduction in sales to, Large Power Customers if we are unable to offset the related lost margins; weaker operating performance; adverse regulatory outcomes; disproportionate increase in the contribution to net income from our Energy Infrastructure and Related Services businesses as compared to that from our Regulated Operations; deteriorating economic or capital market conditions; or volatility in commodity prices.

If we are not able to access capital on acceptable terms in sufficient amounts and when needed, or at all, the ability to maintain our businesses or to implement our business plans would be adversely affected.

Recent U.S. tax legislation could adversely impact our financial position, results of operations and cash flows.

On December 22, 2017, the TCJA was enacted into law. The TCJA has significantly changed the U.S. Internal Revenue Code and the taxation of corporations. The TCJA is unclear in certain respects and will require interpretations and the promulgation of regulations by the Internal Revenue Service, as well as state tax authorities and it could be subject to potential amendments and technical corrections. The regulatory treatment of the impacts of the TCJA will be subject to the discretion of the FERC and state regulatory authorities.

On February 6, 2018, Standard & Poor's downgraded its ratings outlook for ALLETE to negative from stable as a result, among other reasons, of the potential negative impact of the TCJA on certain financial metrics used by credit rating agencies to rate us. It is unclear when or how the capital markets and the credit rating agencies will ultimately respond. Further, there may be other adverse effects resulting from the TCJA or regulatory agency responses to the TCJA that we have not yet identified. We are still quantifying the impacts of the TCJA on our businesses, and have reflected estimates for the impacts in our Consolidated Financial Statements as of December 31, 2017, which may be adjusted in future periods as more information becomes available. The reduction in the federal corporate income tax rate required us to remeasure our existing deferred income tax balances as of the date of enactment, resulting in a non-cash benefit to earnings in our ALLETE Clean Energy and U.S. Water Services segments as well as a non-cash expense at our Corporate and Other businesses. The remeasurement of the existing deferred income tax assets and liabilities for our Regulated Operations segment was recorded as regulatory assets, regulatory liabilities, and a change to our investment in ATC resulting in no material impact on the 2017 results of operations for this segment. The benefits of the TCJA for customers of Minnesota Power and SWL&P are expected to be passed back to those

customers over time primarily based upon the normalization provisions of the U.S. Internal Revenue Code over the life of the related property, plant and equipment with the remainder passed back based upon the determinations of regulatory authorities. The decrease in our investment in ATC is expected to be amortized into earnings over time. The final amount and timing over which the benefits of the TCJA will be passed back to customers has not been determined, and therefore, the full cash flow impacts are still uncertain.

ALLETE, Inc. 2017 Form 10-K

25

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Item 1A. Risk Factors (Continued)

Entity-wide Risks (Continued)

A deterioration in general economic conditions may have adverse impacts on our financial position, results of operations and cash flows.

If economic conditions deteriorate on a national or regional level, it may have a negative impact on the Company's financial position, results of operations and cash flows as well as on our customers. This impact may include volatility and unpredictability in the demand for the products and services offered by our businesses, the loss of existing customers, tempered growth strategies, production cutbacks or customer bankruptcies. An uncertain economy could also adversely affect expenses including pension costs, interest costs, and uncollectible accounts, or lead to reductions in the value of certain real estate and other investments.

We are subject to extensive state and federal legislation and regulation, compliance with which could have an adverse effect on our businesses.

We are subject to, and affected by, extensive state and federal legislation and regulation. If it was determined that our businesses failed to comply with applicable laws and regulations, we could become subject to fines or penalties or be required to implement additional compliance measures or actions, the cost of which could be material. Adoption of new laws, rules, regulations, principles, or practices by federal and state agencies, or changes to or a failure to comply with current laws, rules, regulations, principles, or practices and their interpretations, could have an adverse effect on our financial position, results of operations and cash flows.

The inability to attract and retain a qualified workforce including, but not limited to, executive officers, key employees and employees with specialized skills, could have an adverse effect on our operations.

The success of our business heavily depends on the leadership of our executive officers and key employees to implement our business strategy. The inability to maintain a qualified workforce including, but not limited to, executive officers, key employees and employees with specialized skills, may negatively affect our ability to service our existing or new customers, or successfully manage our business or achieve our business objectives. Personnel costs may increase due to competitive pressures or terms of collective bargaining agreements with union employees.

Market performance and other changes could decrease the value of pension and other postretirement benefit plan assets, which may result in significant additional funding requirements and increased annual expenses.

The performance of the capital markets impacts the values of the assets that are held in trust to satisfy future obligations under our pension and other postretirement benefit plans. We have significant obligations to these plans and the trusts hold significant assets. These assets are subject to market fluctuations and will yield uncertain returns, which may fall below our projected rates of return. A decline in the market value of the pension and other postretirement benefit plan assets would increase the funding requirements under our benefit plans if asset returns do not recover. Additionally, our pension and other postretirement benefit plan liabilities are sensitive to changes in interest rates. As interest rates decrease, the liabilities increase, potentially increasing benefit expense and funding requirements. Our pension and other postretirement benefit plan costs are generally recoverable in our electric rates as allowed by our regulators or through our cost-plus fixed fee coal supply agreements at BNI Energy; however, there is no certainty that regulators will continue to allow recovery of these rising costs in the future.

We are exposed to significant reputational risk.

The Company could suffer negative impacts to its reputation as a result of operational incidents, violations of corporate compliance policies, regulatory violations, or other events which may result in negative customer perception and increased regulatory oversight, each of which could have an adverse effect on our financial position, results of operations and cash flows.

Catastrophic events, such as natural disasters and acts of war, may adversely affect our operations.

Catastrophic events such as fires, earthquakes, explosions, floods, ice storms, tornadoes, or similar occurrences, as well as acts of war, could adversely affect the Company's facilities, operations, financial position, results of operations and cash flows. Although the Company has contingency plans and employs crisis management to respond and recover operations in the event of a severe disruption resulting from such events, these measures may not be successful. Furthermore, despite these measures, if such an occurrence were to occur, our financial position, results of operations and cash flows could be adversely affected.

ALLETE, Inc. 2017 Form 10-K

26

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Item 1A. Risk Factors (Continued)

Entity-wide Risks (Continued)

We are vulnerable to acts of terrorism or cybersecurity attacks.

Our operations may be targets of terrorist activities, including cybersecurity attacks, which could disrupt our ability to produce or distribute some portion of our products. There have been cyber security attacks on U.S. energy infrastructure in the past and there may be such attacks in the future. Our generation, transmission and distribution facilities, information technology systems and other infrastructure facilities and systems could be direct targets of, or otherwise be materially adversely affected by such activities. Computer viruses, terrorism, theft and sabotage could impact our systems and facilities, or those of third parties on which we rely, which may disrupt our operations and adversely impact our results of operations. Our businesses require the continued operation of sophisticated information technology systems and network infrastructure. Our technology systems, or those of third parties on which we rely, may be vulnerable to disability, failures or unauthorized access due to hacking, viruses, acts of war or terrorism and other causes. If those technology systems fail or are breached and not recovered in a timely manner, we may be unable to perform critical business functions and sensitive, confidential and other data could be compromised, which could have an adverse effect on our financial position, results of operations and cash flows.

Government challenges to our tax positions, as well as tax law changes and the inherent difficulty in quantifying potential tax effects of business decisions, could adversely affect our results of operations and liquidity.

We are required to make judgments in order to estimate federal and state tax obligations. These judgments include reserves for potential adverse outcomes for tax positions that may be challenged by tax authorities. The obligations, which include income taxes and taxes other than income taxes, involve complex matters that ultimately could be litigated. We also estimate our ability to use tax benefits, including those in the form of carryforwards and tax credits that are recorded as deferred tax assets on our Consolidated Balance Sheet. A disallowance of these tax benefits could have an adverse impact on our financial position, results of operations and cash flows.

We plan to utilize our carryforwards and tax credits in the future to reduce our income tax obligations. If we cannot generate enough taxable income in the future to utilize all of our carryforwards and tax credits before they expire, we may incur adverse charges to earnings. If federal or state tax authorities disagree with the deductions resulting from our tax planning strategies, our financial position, results of operations and cash flows may be adversely impacted.

Regulated Operations Risks

Our results of operations could be negatively impacted if our Large Power Customers experience an economic downturn, incur work stoppages, fail to compete effectively, experience decreased demand or experience a decline in prices for their product.

Minnesota Power's nine Large Power Customers accounted for 25 percent of our 2017 consolidated operating revenue (22 percent in 2016 and in 2015), of which one of these customers accounted for approximately 10 percent of consolidated revenue in 2017 (8 percent in 2016 and in 2015). These customers are involved in cyclical industries that by their nature are adversely impacted by economic downturns and are subject to strong competition in the marketplace. Additionally, the North American paper and pulp industry also faces declining demand due to the impact of electronic substitution for print and changing customer needs.

Accordingly, if our customers experience an economic downturn, incur a work stoppage (including strikes, lock-outs or other events), fail to compete effectively, experience decreased demand or experience a decline in prices for their product, there could be adverse effects on their operations and, consequently, this could have a negative impact on our

results of operations if we are unable to remarket at similar prices the energy that would otherwise have been sold to such Large Power Customers.

ALLETE, Inc. 2017 Form 10-K

27

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Item 1A. Risk Factors (Continued)  
Regulated Operations Risks (Continued)

Our utility operations are subject to an extensive legal and regulatory framework under federal and state laws as well as regulations imposed by other organizations that may have a negative impact on our business and results of operations.

We are subject to an extensive legal and regulatory framework imposed under federal and state law including regulations administered by the FERC, MPUC, MPCA, PSCW, NDPSC and EPA as well as regulations administered by other organizations including the NERC. These laws and regulations relate to allowed rates of return, capital structure, financings, rate and cost structure, acquisition and disposal of assets and facilities, construction and operation of generation, transmission and distribution facilities (including the ongoing maintenance and reliable operation of such facilities), recovery of purchased power costs and capital investments, approval of integrated resource plans and present or prospective wholesale and retail competition, among other things. Energy policy initiatives at the state or federal level could increase incentives for distributed generation, municipal utility ownership, or local initiatives could introduce generation or distribution requirements that could change the current integrated utility model. Our transmission systems and electric generation facilities are subject to the NERC mandatory reliability standards, including cybersecurity standards. Compliance with these standards may lead to increased operating costs and capital expenditures. If it was determined that we were not in compliance with these mandatory reliability standards or other statutes, rules and orders, we could incur substantial monetary penalties and other sanctions, which could adversely affect our results of operations.

These laws and regulations significantly influence our operations and may affect our ability to recover costs from our customers. We are required to have numerous permits, licenses, approvals and certificates from the agencies and other organizations that regulate our business. We believe we have obtained the necessary permits, licenses, approvals and certificates for our existing operations and that our business is conducted in accordance with applicable laws; however, we are unable to predict the impact on our operating results from the future regulatory activities of any of these agencies and other organizations. Changes in regulations or the adoption of new regulations could have an adverse impact on our results of operations.

Our ability to obtain rate adjustments to maintain reasonable rates of return depends upon regulatory action under applicable statutes and regulations, and we cannot provide assurance that rate adjustments will be obtained or reasonable authorized rates of return on capital will be earned. Minnesota Power and SWL&P, from time to time, file general rate cases with, or otherwise seek cost recovery authorization from, federal and state regulatory authorities. If Minnesota Power and SWL&P do not receive an adequate amount of rate relief in general rate cases, including if rates are reduced, if increased rates are not approved on a timely basis or costs are otherwise unable to be recovered through rates, or if cost recovery is not granted at the requested level, we may experience an adverse impact on our financial position, results of operations and cash flows. We are unable to predict the impact on our business and results of operations from future legislation or regulatory activities of any of these agencies or organizations.

Our operations present certain environmental risks that could adversely affect our financial position and results of operations, including effects of environmental laws and regulations, physical risks associated with climate change and initiatives designed to reduce the impact of GHG emissions.

We are subject to extensive environmental laws and regulations affecting many aspects of our present and future operations, including air quality, water quality and usage, waste management, reclamation, hazardous wastes, avian mortality and natural resources. These laws and regulations can result in increased capital expenditures, environmental emission allowance trading, operating and other costs, as a result of compliance, remediation, containment and monitoring obligations, particularly with regard to laws relating to power plant emissions, coal ash, water discharge

and wind energy facilities.

These laws and regulations could restrict the output of some existing facilities, limit the use of some fuels in the production of electricity, require the installation of additional pollution control equipment, require participation in environmental emission allowance trading, and lead to other environmental considerations and costs, which could have an adverse impact on our business, operations and results of operations.

These laws and regulations generally require us to obtain and comply with a wide variety of environmental licenses, permits, inspections and other approvals. Violations of these laws and regulations could expose us to regulatory and legal proceedings, disputes with, and legal challenges by, governmental authorities and private parties, as well as potential significant civil fines criminal penalties and other sanctions.

Existing environmental regulations may be revised and new environmental regulations may be adopted or become applicable to us. Revised or additional regulations which result in increased compliance costs or additional operating restrictions, particularly if those costs are not fully recoverable from customers, could have an adverse effect on our results of operations.

ALLETE, Inc. 2017 Form 10-K

28

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Item 1A. Risk Factors (Continued)  
Regulated Operations Risks (Continued)

The scientific community generally accepts that emissions of GHG are linked to global climate change. Physical risks of climate change, such as more frequent or more extreme weather events, changes in temperature and precipitation patterns, changes to ground and surface water availability, and other related phenomena, could affect some, or all, of our operations. Severe weather or other natural disasters could be destructive, which could result in increased costs. An extreme weather event within our utility service areas can also directly affect our capital assets, causing disruption in service to customers due to downed wires and poles or damage to other operating equipment. These all have the potential to adversely affect our business and operations.

There is significant uncertainty regarding if and when new laws or regulations will be adopted to reduce GHGs and the impact any such laws or regulations would have on us. In 2017, coal was the primary fuel source for 70 percent of the energy produced by our generating facilities. Any future limits on GHG emissions would likely require us to incur significant capital expenditures and increases in operating costs, which if significant, could result in the closure of certain coal-fired energy centers, an impairment of assets, or otherwise adversely affect our results of operations, particularly if such expenditures and costs are not fully recoverable from customers.

We cannot predict the amount or timing of all future expenditures related to environmental matters because of uncertainty as to applicable regulations or requirements. There is also uncertainty in quantifying liabilities under environmental laws that impose joint and several liability on all potentially responsible parties. Violations of certain environmental statutes, rules and regulations could expose ALLETE to third party disputes and potentially significant monetary penalties, as well as other sanctions for non compliance.

The operation and maintenance of our electric generation and transmission facilities are subject to operational risks that could adversely affect our financial position, results of operations and cash flows.

The operation of generating facilities involves many risks, including start-up operations risks, breakdown or failure of facilities, the dependence on a specific fuel source, inadequate fuel supply, availability of fuel transportation, or the impact of unusual or adverse weather conditions or other natural events, as well as the risk of performance below expected levels of output or efficiency. A significant portion of our facilities contain older generating equipment, even if maintained in accordance with good engineering practices, may require significant capital expenditures to continue operating at peak efficiency. Generation and transmission facilities and equipment are also likely to require periodic upgrades and improvements due to changing environmental standards and technological advances. We could be subject to costs associated with any unexpected failure to produce or deliver power, including failure caused by breakdown or forced outage, as well as repairing damage to facilities due to storms, natural disasters, wars, sabotage, terrorist acts and other catastrophic events.

Our ability to successfully and timely complete capital improvements to existing facilities or other capital projects is contingent upon many variables.

We expect to incur significant capital expenditures in making capital improvements to our existing electric generation and transmission facilities and in the development and construction of new electric generation and transmission facilities. Should any such efforts be unsuccessful or not completed in a timely manner, we could be subject to additional costs or impairments which could have an adverse impact on our financial position and results of operation.

Our electric generating operations may not have access to adequate and reliable transmission and distribution facilities necessary to deliver electricity to our customers.

We depend on our own transmission and distribution facilities, as well as facilities owned by other utilities, to deliver the electricity produced and sold to our customers, and to other energy suppliers. If transmission capacity is inadequate, our ability to sell and deliver electricity may be limited. We may have to forgo sales or may have to buy more expensive wholesale electricity that is available in the capacity-constrained area. In addition, any infrastructure failure that interrupts or impairs delivery of electricity to our customers could negatively impact the satisfaction of our customers, which could have an adverse impact on our business and results of operations.

ALLETE, Inc. 2017 Form 10-K

29

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Item 1A. Risk Factors (Continued)  
Regulated Operations Risks (Continued)

Our results of operations could be impacted by declining wholesale power prices.

Wholesale prices for electricity have declined in recent years primarily due to low natural gas prices. If there are reductions in demand from customers or if we lose customers, we will market any available power to Other Power Suppliers in an effort to mitigate any earnings impact. Sales to Other Power Suppliers are sold at market-based prices into the MISO market on a daily basis or through bilateral agreements of various durations. Due to the low wholesale prices for electricity, we can make no assurances that our power marketing efforts would fully offset any reduction in earnings resulting from the lower demand from existing customers or the loss of customers.

The price of electricity and fuel may be volatile.

Volatility in market prices for electricity and fuel could adversely impact our financial position and results of operations and may result from:

- severe or unexpected weather conditions and natural disasters;
- seasonality;
- changes in electricity usage;
- transmission or transportation constraints, inoperability or inefficiencies;
- availability of competitively priced alternative energy sources;
- changes in supply and demand for energy;
- changes in power production capacity;
- outages at our generating facilities or those of our competitors;
- availability of fuel transportation;
- changes in production and storage levels of natural gas, lignite, coal, crude oil and refined products;
- wars, sabotage, terrorist acts or other catastrophic events; and
- federal, state, local and foreign energy, environmental, or other regulation and legislation.

Fluctuations in our fuel and purchased power costs related to our retail and municipal customers are passed on to customers through the fuel adjustment clause. Volatility in market prices for our fuel and purchase power costs primarily impacts our sales to Other Power Suppliers.

Demand for energy may decrease.

Our results of operations are impacted by the demand for energy in our service territories. There could be lower demand for energy due to a loss of customers as a result of economic conditions, customers constructing their own generation facilities, higher costs and rates charged to customers, or loss of service territory or franchises. Further, energy conservation and technological advances that increased energy efficiency may temporarily or permanently reduce the demand for energy products. In addition, we are impacted by state and federal regulations requiring mandatory conservation measures, which would reduce the demand for energy products. Continuing technology improvements and regulatory developments may make customer and third party-owned generation technologies such as rooftop solar systems, WTGs, microturbines and battery storage systems more cost effective and feasible for more of our customers. If more customers utilize their own generation, demand for energy from us would decline. There may not be future economic growth opportunities that would enable us to replace the lost energy demand from these customers. Therefore, a decrease in demand for energy could adversely impact our financial position, results of operations and cash flows.

We may not be able to successfully implement our strategic objectives of growing load at our utilities if current or potential industrial or municipal customers are unable to successfully implement expansion plans, including the inability to obtain necessary governmental permits.

As part of our long-term strategy, we pursue new wholesale and retail loads in and around our service territories. Currently, there are several companies in northeastern Minnesota that are in the process of developing natural resource-based projects that represent long-term growth potential and load diversity for our Regulated Operations businesses. These projects may include construction of new facilities and restarts of old facilities, both of which require permitting and approvals to be obtained before the projects can be successfully implemented. If a project does not obtain any necessary governmental (including environmental) permits and approvals or if these customers are unable to successfully implement expansion plans, our long-term strategy and thus our results of operations could be adversely impacted.

ALLETE, Inc. 2017 Form 10-K

30

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Item 1A. Risk Factors (Continued)

Energy Infrastructure and Related Services Risks

The inability to successfully manage and grow our Energy Infrastructure and Related Services businesses could adversely affect our results of operations.

Our Energy Infrastructure and Related Services businesses consist of ALLETE Clean Energy and U.S. Water Services. The Company's strategy for these businesses includes adding customers, products, and new geographies, project development for others and growth through acquisitions. This strategy depends, in part, on the Company's ability to successfully identify and evaluate acquisition opportunities and consummate acquisitions on acceptable terms. The Company may compete with other companies for these acquisition opportunities, which may increase the Company's cost of making acquisitions and the Company may be unsuccessful in pursuing these acquisition opportunities. These companies may be able to pay more for acquisitions and may be able to identify, evaluate, bid for and purchase a greater number of assets than the Company's financial or human resources permit. Additionally, tax law changes may adversely impact the economic characteristics of potential acquisitions or investments. If the Company is unable to execute its strategy of growth through acquisitions, project development for others, or the addition of new customers, products and geographies, it may impede our long-term objectives and business strategy.

Acquisitions are subject to uncertainties. If we are unable to successfully integrate and manage future acquisitions or strategic investments, this could have an adverse impact on our results of operations. Our actual results may also differ from our expectations due to factors such as the ability to obtain timely regulatory or governmental approvals, integration and operational issues and the ability to retain management and other key personnel.

U.S. Water Services principally relies upon recurring revenues from a diverse mix of industrial customers. Some of these customers can be adversely affected by low commodity prices such as those for ethanol and oil which may cause these customers to purchase less of U.S. Water Services' products and services. If U.S. Water Services is unable to retain its existing customers, add new customers, or if it experiences reduced demand for its products and services, adverse impacts on our results of operations could occur that would prevent us from achieving our future growth expectations.

The generation of electricity from ALLETE Clean Energy's wind energy facilities depends heavily on suitable meteorological conditions.

ALLETE Clean Energy's facilities are geographically diverse; however, if wind conditions are unfavorable, ALLETE Clean Energy's electricity generation and revenue from its wind energy facilities may be substantially below its expectations. The electricity produced, production tax credits received, and revenues generated by a wind energy facility are highly dependent on suitable wind conditions and associated weather conditions, which are beyond ALLETE Clean Energy's control. Furthermore, components of its systems could be damaged by severe weather, such as hailstorms, lightning or tornadoes. In addition, replacement and spare parts for key components of ALLETE Clean Energy's diverse turbine portfolio may be difficult or costly to acquire or may be unavailable. Unfavorable weather and atmospheric conditions could impair the effectiveness of ALLETE Clean Energy's assets or reduce their output beneath their rated capacity or require shutdown of key equipment, impeding operation of its wind energy facilities.

The operation and maintenance of ALLETE Clean Energy's electric generation facilities are subject to operational risks that could adversely affect our financial position, results of operations and cash flows.

The operation of generating facilities involves many risks, including start-up operations risks, breakdown or failure of facilities, the dependence on the availability of wind resources, or the impact of unusual, adverse weather conditions

or other natural events, as well as the risk of performance below expected levels of output or efficiency. A portion of our facilities contain older generating equipment, even if maintained in accordance with good engineering practices, may require significant capital expenditures to continue operating at peak efficiency. We could be subject to costs associated with any unexpected failure to produce and deliver power, including failure caused by breakdown or forced outage, as well as repairing damage to facilities due to storms, natural disasters, wars, sabotage, terrorist acts and other catastrophic events.

ALLETE, Inc. 2017 Form 10-K

31

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Item 1A. Risk Factors (Continued)

Energy Infrastructure and Related Services Risks (Continued)

As contracts with its counterparties expire, ALLETE Clean Energy may not be able to replace them with agreements on similar terms.

ALLETE Clean Energy is party to PSAs which expire in various years between 2018 and 2032. These PSA expirations are prior to the end of the estimated useful lives of the respective wind energy facilities. If, for any reason, ALLETE Clean Energy is unable to enter into new agreements with existing or new counterparties on similar terms once the current agreements expire, or sell energy in the wholesale market resulting in similar revenue, our financial position, results of operations and cash flows could be adversely affected.

Counterparties to ALLETE Clean Energy's offtake agreements may not fulfill their obligations.

ALLETE Clean Energy is party to PSAs under various durations with a limited number of creditworthy counterparties. If, for any reason, any of the counterparties under these agreements do not fulfill their related contractual obligations, and ALLETE Clean Energy is unable to remarket the energy resulting in similar revenue, our financial position, results of operations and cash flows could be adversely affected.

ALLETE has a significant amount of goodwill and intangible assets. A determination that goodwill or intangible assets have been impaired could result in a significant non-cash charge to earnings.

We had approximately \$226 million of goodwill and intangible assets recorded on our Consolidated Balance Sheet as of December 31, 2017, relating to our initial acquisition of U.S. Water Services in 2015 as well as U.S. Water Services' subsequent acquisitions. If we change our business strategy, fail to deliver on our projected results or if market or other conditions adversely affect the operations of U.S. Water Services, we may be required to record an impairment charge. Declines in projected operating cash flows at U.S. Water Services could also result in an impairment charge. An impairment charge would result in a non-cash charge to earnings that could have an adverse effect on our results of operations.

Corporate and Other Risks

BNI Energy may be adversely impacted by its exposure to customer concentration, and environmental laws and regulations.

BNI Energy sells lignite coal to two electric generating cooperatives, Minnkota Power and Square Butte, and could be adversely impacted if these customers were unable or unwilling to fulfill their related contractual obligations. In addition, BNI Energy and its customers may be adversely impacted by environmental laws and regulations which could have an adverse effect on our financial position, results of operations and cash flows.

Real estate market conditions where our legacy Florida real estate investment is located may not improve.

The Company's strategy related to the real estate assets of ALLETE Properties incorporates the possibility of a bulk sale of its entire portfolio, in addition to sales over time, however, continued adverse market conditions could impact the timing of land sales, which could result in little to no sales, while still incurring operating expenses such as community development district assessments and property taxes, resulting in net operating losses at ALLETE Properties. Furthermore, weak market conditions could put the properties at risk for an impairment charge. An impairment charge would result in a non-cash charge to earnings that could have an adverse effect on our results of operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

A discussion of our properties is included in Item 1. Business and is incorporated by reference herein.

ALLETE, Inc. 2017 Form 10-K

32

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### Item 3. Legal Proceedings

Discussions of material regulatory and environmental proceedings are included in Note 4. Regulatory Matters and Note 11. Commitments, Guarantees and Contingencies, and are incorporated by reference herein.

We are involved in litigation arising in the normal course of business. Also in the normal course of business, we are involved in tax, regulatory and other governmental audits, inspections, investigations and other proceedings that involve state and federal taxes, safety, and compliance with regulations, rate base and cost of service issues, among other things. We do not expect the outcome of these matters to have a material effect on our financial position, results of operations or cash flows.

### Item 4. Mine Safety Disclosures

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires issuers to include in periodic reports filed with the SEC certain information relating to citations or orders for violations of standards under the Federal Mine Safety and Health Act of 1977 (Mine Safety Act). Information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Act and this Item are included in Exhibit 95 to this Form 10-K.

## Part II

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

Our common stock is listed on the NYSE under the symbol ALE. We have paid dividends, without interruption, on our common stock since 1948. A quarterly dividend of \$0.56 per share on our common stock is payable on March 1, 2018, to the shareholders of record on February 15, 2018. The timing and amount of future dividends will depend upon earnings, cash requirements, the financial condition of the Company, applicable government regulations and other factors deemed relevant by the ALLETE Board of Directors.

The following table shows dividends declared per share, and the high and low prices of our common stock for the periods indicated as reported by the NYSE:

Quarter	2017			2016		
	Price High	Price Low	Dividends Declared	Price High	Price Low	Dividends Declared
First	\$68.38	\$61.64	\$0.535	\$58.34	\$48.26	\$0.52
Second	\$74.59	\$66.81	0.535	\$64.69	\$53.47	0.52
Third	\$79.61	\$69.79	0.535	\$65.41	\$52.50	0.52
Fourth	\$81.24	\$72.96	0.535	\$66.92	\$56.48	0.52
Annual Total			\$2.14			\$2.08

As of February 1, 2018, there were approximately 23,000 common stock shareholders of record.

ALLETE, Inc. 2017 Form 10-K

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities (Continued)

Performance Graph.

The following graph compares ALLETE’s cumulative Total Shareholder Return on its common stock with the cumulative return of the S&P 500 Index and the Philadelphia Utility Index. The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Because this composite index has a broad industry base, its performance may not closely track that of a composite index comprised solely of electric utilities. The Philadelphia Utility Index is a capitalization-weighted index of 20 utility companies involved in the generation of electricity.

The calculations assume a \$100 investment on December 31, 2012, and reinvestment of dividends.

	2012	2013	2014	2015	2016	2017
ALLETE	\$100	\$127	\$146	\$140	\$183	\$218
S&P 500 Index	\$100	\$132	\$150	\$153	\$171	\$208
Philadelphia Utility Index	\$100	\$111	\$143	\$152	\$178	\$201

ALLETE, Inc. 2017 Form 10-K

34

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## Item 6. Selected Financial Data

	2017	2016	2015	2014	2013	
Millions Except Per Share Amounts						
Operating Revenue (a)	\$1,419.3	\$1,339.7	\$1,486.4	\$1,136.8	\$1,018.4	
Operating Expenses (a)	\$1,189.5	\$1,116.2	\$1,275.7	\$948.0	\$864.3	
Net Income (b)	\$172.2	\$155.8	\$141.5	\$125.5	\$104.7	
Less: Non-Controlling Interest in Subsidiaries (c)	—	0.5	0.4	0.7	—	
Net Income Attributable to ALLETE (b)	\$172.2	\$155.3	\$141.1	\$124.8	\$104.7	
Common Stock Dividends	108.7	102.7	97.9	83.8	75.2	
Earnings Retained in Business (b)	\$63.5	\$52.6	\$43.2	\$41.0	\$29.5	
Shares Outstanding						
Year-End	51.1	49.6	49.1	45.9	41.4	
Average (d)						
Basic	50.8	49.3	48.3	42.9	39.7	
Diluted	51.0	49.5	48.4	43.1	39.8	
Diluted Earnings Per Share (b)	\$3.38	\$3.14	\$2.92	\$2.90	\$2.63	
Total Assets (e)	\$5,080.0	\$4,876.9	\$4,864.4	\$4,329.1	\$3,458.6	
Long-Term Debt	\$1,439.2	\$1,370.4	\$1,556.7	\$1,263.2	\$1,074.9	
Return on Common Equity (b)	8.6	%8.4	%8.0	%8.6	%8.3	%
Common Equity Ratio	58	%55	%53	%54	%55	%
Dividends Declared per Common Share	\$2.14	\$2.08	\$2.02	\$1.96	\$1.90	
Dividend Payout Ratio (b)	63	%66	%69	%68	%72	%
Book Value Per Share at Year-End	\$40.46	\$38.17	\$37.18	\$35.04	\$32.43	
Capital Expenditures by Segment						
Regulated Operations	\$177.1	\$121.8	\$224.4	\$583.5	\$326.3	
ALLETE Clean Energy	56.1	106.9	8.6	4.2	—	
U.S. Water Services	4.4	3.7	2.9	—	—	
Corporate and Other	28.9	15.4	15.9	16.6	13.2	
Total Capital Expenditures	\$266.5	\$247.8	\$251.8	\$604.3	\$339.5	

(a) In 2015, operating revenue and operating expenses included the construction and sale of a wind energy facility from ALLETE Clean Energy to Montana-Dakota Utilities for \$197.7 million and \$162.9 million, respectively.

(b) The year ended December 31, 2017, includes the impact of the remeasurement of deferred income tax assets and liabilities resulting from the TCJA. (See Note 1. Operations and Significant Accounting Policies.)

(c) The non-controlling interest related to ALLETE Clean Energy's Condon wind energy facility was acquired in April 2016. (See Note 6. Acquisitions.)

(d) Excludes unallocated ESOP shares in 2013 and 2014.

(e) During the first quarter of 2017, the Company identified an error related to the deferred income tax treatment associated with its Wholesale and Retail Contra AFUDC Regulatory Liability resulting in a decrease in Regulatory Assets and Deferred Income Taxes. The periods presented have been revised for the correction of the error. (See Note 1. Operations and Significant Accounting Policies.)

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our Consolidated Financial Statements and notes to those statements and the other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this Form 10-K contain forward-looking information that involves risks and uncertainties. Readers are cautioned that forward-looking statements should be read in conjunction with our disclosures in this Form 10-K under the headings: "Forward Looking Statements" located on page 6 and "Risk Factors"

located in Item 1A. The risks and uncertainties described in this Form 10-K are not the only risks facing our Company. Additional risks and uncertainties that we are not presently aware of, or that we currently consider immaterial, may also affect our business operations. Our business, financial condition or results of operations could suffer if the risks are realized.

ALLETE, Inc. 2017 Form 10-K

35

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## Overview

**Basis of Presentation.** We present three reportable segments: Regulated Operations, ALLETE Clean Energy and U.S. Water Services. Our segments were determined in accordance with the guidance on segment reporting. We measure performance of our operations through budgeting and monitoring of contributions to consolidated net income by each business segment.

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 portions 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 utility 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. (See Note 4. Regulatory Matters.)

ALLETE Clean Energy 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 is contracted under PSAs of various durations. ALLETE Clean Energy also engages in the development of wind energy facilities to operate under long-term PSAs or for sale to others upon completion.

U.S. Water Services provides integrated water management for industry by combining chemical, equipment, engineering and service for customized solutions to reduce water and energy usage, and improve efficiency.

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, 2017, 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.

## 2017 Financial Overview

The following net income discussion summarizes a comparison of the year ended December 31, 2017, to the year ended December 31, 2016.

Net income attributable to ALLETE in 2017 was \$172.2 million, or \$3.38 per diluted share, compared to \$155.3 million, or \$3.14 per diluted share, in 2016. Net income in 2017 included the favorable impacts of \$13.0 million after-tax, or \$0.25 per share, for the remeasurement of deferred income tax assets and liabilities resulting from the TCJA (see Note 1. Operations and Significant Accounting Policies) and \$7.9 million after-tax, or \$0.16 per share, related to the regulatory outcome of the MPUC’s modification of its November 2016 order on the allocation of North Dakota investment tax credits. Net income in 2017 also included a non-cash \$11.4 million after-tax charge, or \$0.22 per share, for the MPUC’s decision in Minnesota Power’s 2016 general rate case at a hearing on January 18, 2018, disallowing recovery of Minnesota Power’s regulatory asset for deferred fuel adjustment clause costs due to the anticipated adoption of a forward-looking fuel adjustment clause methodology. (See Note 4. Regulatory Matters.) Net

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income in 2016 included the favorable impact related to the change in fair value of the contingent consideration liability of \$13.6 million after-tax, or \$0.28 per share. Net income in 2016 also included an adverse impact of \$8.8 million after tax, or \$0.18 per share, for the regulatory outcome of the November 2016 MPUC order on the allocation of North Dakota investment tax credits, a \$3.3 million after tax, or \$0.07 per share, goodwill impairment charge and a \$0.9 million after-tax expense, or \$0.02 per share, related to the repayment of long-term debt at ALLETE Clean Energy. Earnings per share dilution in 2017 was \$0.11 due to additional shares of common stock outstanding as of December 31, 2017.

ALLETE, Inc. 2017 Form 10-K

36

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## 2017 Financial Overview (Continued)

Regulated Operations net income attributable to ALLETE was \$128.4 million in 2017, compared to \$135.5 million in 2016. Net income in 2017 at Minnesota Power decreased \$9.8 million after-tax reflecting a non-cash \$11.4 million after-tax charge for the MPUC's decision disallowing the recovery of Minnesota Power's regulatory asset for deferred fuel adjustment clause costs due to the anticipated adoption of a forward-looking fuel adjustment clause methodology. In addition, net income decreased due to lower kWh sales to other power suppliers as a result of higher industrial sales coupled with lower market prices, higher interest and taxes other than income taxes, and lower kWh sales to residential, commercial and municipal customers due to milder temperatures in 2017. These decreases were partially offset by lower depreciation expense of \$14.6 million after-tax resulting from the MPUC's decision to modify the depreciable lives at Boswell, and higher industrial kWh sales. Interim retail rate refund reserves fully offset the interim retail rates recognized during 2017 due to the regulatory outcome of the MPUC's decisions in Minnesota Power's 2016 general rate case on January 18, 2018. Our equity earnings in ATC for 2017 increased \$2.6 million after tax primarily due to additional investments in ATC and period over period changes in ATC's estimate of a refund liability related to MISO return on equity complaints.

ALLETE Clean Energy net income attributable to ALLETE was \$41.5 million in 2017 compared to \$13.4 million in 2016. Net income in 2017 reflected a \$23.6 million after-tax benefit due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA, increased production tax credits due to the requalification of WTGs for production tax credits at its Storm Lake I, Storm Lake II and Lake Benton wind energy facilities, lower operating and maintenance expenses, and lower interest expense compared to 2016. Net income in 2016 included a \$3.3 million after-tax goodwill impairment charge and a \$0.9 million after-tax expense related to the repayment of long-term debt. Net income in 2016 also included an allocation of earnings to a non-controlling interest in the limited liability company that owns the Condon wind energy facility, which was acquired by ALLETE Clean Energy in April 2016. (See Note 6. Acquisitions.)

U.S. Water Services net income attributable to ALLETE was \$10.7 million in 2017, compared to \$1.5 million in 2016. Net income in 2017 reflected a \$9.2 million after-tax benefit due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA, and higher operating revenue, partially offset by increased operating expenses as a result of investments for future growth in waste treatment and water safety applications. Net income in 2017 also included a net loss of \$0.8 million primarily for transaction fees and amortization expense of the Tonka Water acquisition on September 1, 2017. (See Note 6. Acquisitions.)

Corporate and Other net loss attributable to ALLETE was \$8.4 million in 2017, compared to net income of \$4.9 million in 2016. The net loss in 2017 included additional income tax expense of \$19.8 million after-tax for the remeasurement of deferred income tax assets and liabilities resulting from the TCJA. The net loss in 2017 also included a \$7.9 million after-tax favorable impact for the regulatory outcome of the MPUC's modification of its November 2016 order on the allocation of North Dakota investment tax credits, lower accretion expense relating to the contingent consideration liability, and lower interest expense. Net income in 2016 included an after-tax gain of \$13.6 million related to the change in fair value of the contingent consideration liability, partially offset by an \$8.8 million after-tax adverse impact for the regulatory outcome of the November 2016 MPUC order.

## 2017 Compared to 2016

(See Note 17. Business Segments for financial results by segment.)

## Regulated Operations

Year Ended December 31	2017	2016
Millions		
Operating Revenue – Utility	\$1,063.8	\$1,000.7
Fuel, Purchased Power and Gas – Utility	396.9	339.9
Transmission Services – Utility	71.2	65.2
Operating and Maintenance	223.1	220.7
Depreciation and Amortization	132.6	154.3
Taxes Other than Income Taxes	51.1	47.7
Operating Income	188.9	172.9
Interest Expense	(57.0)	(52.1)
Equity Earnings in ATC	22.5	18.5
Other Income	1.2	2.1
Income Before Income Taxes	155.6	141.4
Income Tax Expense	27.2	5.9
Net Income Attributable to ALLETE	\$128.4	\$135.5

Operating Revenue – Utility increased \$63.1 million, or 6 percent, from 2016 primarily due to the period over period impact of the regulatory outcomes related to the allocation of North Dakota investment tax credits, as well as higher fuel adjustment clause recoveries, conservation improvement program recoveries and revenue from kWh sales, partially offset by lower FERC formula-based rates, financial incentives under the conservation improvement program and transmission revenue. Interim retail rate refund reserves fully offset the interim retail rates recognized during 2017.

Revenue increased \$29.3 million due to the period over period impact of the regulatory outcomes related to the allocation of North Dakota investment tax credits. As a result of the favorable impact for the regulatory outcome of the MPUC's modification of its November 2016 order on the allocation of North Dakota investment tax credits, operating revenue increased approximately \$14 million in 2017. In 2016, operating revenue decreased approximately \$15 million as a result of the adverse impact for the regulatory outcome of the November 2016 MPUC order. (See Note 4. Regulatory Matters.)

Fuel adjustment clause recoveries increased \$24.4 million due to higher fuel and purchased power costs attributable to retail and municipal customers. (See Operating Expenses - Fuel, Purchased Power and Gas – Utility.)

Conservation improvement program recoveries increased \$7.2 million from 2016 primarily due to an increase in related expenditures. (See Operating Expenses - Operating and Maintenance.)

Revenue from kWh sales increased \$3.9 million from 2016 primarily due to higher sales to Industrial customers. Sales to Industrial customers increased 13.5 percent primarily due to increased taconite production and the commencement of a long term PSA with Silver Bay Power in June 2016. Sales to Other Power Suppliers decreased 6.4 percent from 2016 as a result of increased sales to Industrial customers. Sales to Other Power Suppliers are sold at market based prices into the MISO market on a daily basis or through bilateral agreements of various durations; market prices were lower in 2017 compared to 2016. Sales to Residential, Commercial and Municipal customers decreased primarily due to milder temperatures in 2017.





## 2017 Compared to 2016 (Continued)

## Regulated Operations (Continued)

	2017	2016	Quantity Variance	% Variance
Kilowatt-hours Sold Millions				
Regulated Utility				
Retail and Municipal				
Residential	1,096	1,102	(6	) (0.5 )
Commercial	1,420	1,442	(22	) (1.5 )
Industrial	7,327	6,456	871	13.5
Municipal	799	816	(17	) (2.1 )
Total Retail and Municipal	10,642	9,816	826	8.4
Other Power Suppliers	4,039	4,316	(277	) (6.4 )
Total Regulated Utility Kilowatt-hours Sold	14,681	14,132	549	3.9

Revenue from electric sales to taconite and iron concentrate customers accounted for 22 percent of consolidated operating revenue in 2017 (18 percent in 2016). Revenue from electric sales to paper, pulp and secondary wood product customers accounted for 5 percent of consolidated operating revenue in 2017 (6 percent in 2016). Revenue from electric sales to pipelines and other industrial customers accounted for 7 percent of consolidated operating revenue in 2017 (7 percent in 2016).

Interim retail rates for Minnesota Power were approved by the MPUC and became effective January 1, 2017. Interim retail rate refund reserves of \$31.6 million fully offset the interim retail rates recognized during 2017 due to the regulatory outcome of the MPUC's decision in Minnesota Power's 2016 general rate case on January 18, 2018. (See Note 4. Regulatory Matters.)

Revenue from wholesale customers under FERC formula-based rates decreased \$4.9 million from 2016 primarily due to lower rates.

Financial incentives under the conservation improvement program decreased \$1.9 million from 2016.

Transmission revenue decreased \$1.7 million primarily due to lower MISO-related revenue, partially offset by period over period changes in the estimate of a refund liability related to MISO return on equity complaints. (See Operating Expenses - Transmission Services – Utility.)

Operating Expenses increased \$47.1 million, or 6 percent, from 2016.

Fuel, Purchased Power and Gas – Utility expense increased \$57.0 million, or 17 percent, from 2016 primarily due to increased kWh sales, higher fuel costs and a \$19.5 million expense for the MPUC's decision disallowing recovery of Minnesota Power's regulatory asset for deferred fuel adjustment clause costs at a hearing on January 18, 2018, due to the anticipated adoption of a forward-looking fuel adjustment clause methodology. These increases were partially offset by lower purchased power prices. Fuel and purchased power expense related to our retail and municipal customers is recovered through the fuel adjustment clause. (See Operating Revenue – Utility.)

Transmission Services – Utility expense increased \$6.0 million, or 9 percent, from 2016 primarily due to higher MISO-related expense. (See Operating Revenue – Utility.)

Operating and Maintenance expense increased \$2.4 million, or 1 percent, from 2016 primarily due to a \$7.2 million increase in conservation improvement program expenses in 2017. Conservation improvement program expenses are

recovered from certain retail customers. (See Operating Revenue – Utility.) This increase was partially offset by lower materials purchased for generation facilities. Operating and Maintenance expense in 2016 included a \$3.6 million sales tax refund, partially offset by higher storm restoration costs of \$2.9 million related to severe wind storms across Minnesota Power’s service territory in July 2016.

ALLETE, Inc. 2017 Form 10-K

39

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## 2017 Compared to 2016 (Continued)

## Regulated Operations (Continued)

Depreciation and Amortization expense decreased \$21.7 million, or 14 percent, from 2016 primarily due to modifications of the depreciable lives for Boswell, partially offset by additional property, plant and equipment in service. At a hearing on January 18, 2018, the MPUC decided to extend the depreciable lives of Boswell Unit 3, Unit 4 and common facilities to 2050, and shorten the depreciable lives of Boswell Unit 1 and Unit 2 to 2022, resulting in a net decrease to depreciation expense of approximately \$25 million in 2017.

Taxes Other than Income Taxes increased \$3.4 million, or 7 percent, from 2016 primarily due to higher property tax expenses resulting from higher taxable plant.

Interest Expense increased \$4.9 million, or 9 percent, from 2016 primarily due to higher average interest rates. We record interest expense for Regulated Operations primarily based on rate base and authorized capital structure, and allocate the balance to Corporate and Other.

Equity Earnings in ATC increased \$4.0 million, or 22 percent, from 2016 primarily due to additional investments in ATC and period over period changes in ATC's estimate of a refund liability related to MISO return on equity complaints. (See Note 5. Investment in ATC.)

Income Tax Expense increased \$21.3 million from 2016 primarily due to the period over period impact of the regulatory outcomes related to the allocation of North Dakota investment tax credits and higher pre-tax income. The TCJA did not have an impact on income tax expense for our Regulated Operations as the remeasurement of deferred income tax assets and liabilities primarily resulted in the recording of regulatory assets and liabilities.

In 2017, as a result of the favorable impact for the regulatory outcome of the MPUC's modification of its November 2016 order on the allocation of North Dakota investment tax credits, Regulated Operations increased operating revenue and reduced the corresponding regulatory liability by approximately \$14 million resulting in an income tax expense of \$6.1 million. In addition, Regulated Operations recorded an income tax expense of \$7.9 million for North Dakota investment tax credits transferred to Corporate and Other, resulting in no impact to net income for Regulated Operations. Corporate and Other recorded an offsetting income tax benefit of \$7.9 million for the North Dakota investment tax credits transferred from Regulated Operations.

In 2016, as a result of the adverse impact for the regulatory outcome of the November 2016 MPUC order, Regulated Operations reduced operating revenue and recorded a corresponding regulatory liability for approximately \$15 million resulting in an income tax benefit of \$6.2 million. In addition, Regulated Operations recorded an income tax benefit of \$8.8 million for North Dakota investment tax credits transferred from Corporate and Other, resulting in no impact to net income for Regulated Operations. Corporate and Other recorded an offsetting income tax expense of \$8.8 million for the North Dakota investment tax credits transferred to Regulated Operations.

## ALLETE Clean Energy

Year Ended December 31	2017	2016
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Millions

Operating Revenue	\$80.5	\$80.5
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Net Income Attributable to ALLETE (a)	\$41.5	\$13.4
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(a) Results in 2017 include a \$23.6 million after-tax benefit due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA.

Operating Revenue is consistent with 2016 as lower kWh sales at the wind energy facilities resulting from lower wind resources were offset by higher amortization of PSAs. (See Note 1. Operations and Significant Accounting Policies.)

ALLETE, Inc. 2017 Form 10-K

40

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2017 Compared to 2016 (Continued)  
ALLETE Clean Energy (Continued)

	Year Ended December 31,			
	2017		2016	
Production and Operating Revenue	kWh	Revenue	kWh	Revenue
Millions				
Wind Energy Facility				
Lake Benton	241.8	\$12.3	254.7	\$12.8
Storm Lake II	152.6	10.0	154.8	10.1
Condon	90.7	7.5	96.9	8.2
Storm Lake I	215.6	12.4	222.3	11.6
Chanarambie/Viking	263.5	13.9	278.8	13.4
Armenia Mountain	267.4	24.4	268.2	24.4
Total Production and Operating Revenue	1,231.6	\$80.5	1,275.7	\$80.5

Net Income Attributable to ALLETE increased \$28.1 million from 2016. Net income in 2017 included a \$23.6 million after tax benefit due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA, increased production tax credits due to the requalification of WTGs at ALLETE Clean Energy's Storm Lake I, Storm Lake II and Lake Benton wind energy facilities, lower operating and maintenance expense, and lower interest expense compared to 2016. Net income in 2016 included a \$3.3 million after-tax goodwill impairment charge and a \$0.9 million after-tax expense related to the repayment of long-term debt. Net income in 2016 also included an allocation of earnings to a non-controlling interest in the limited liability company that owns the Condon wind energy facility, which was acquired by ALLETE Clean Energy in April 2016. (See Note 6. Acquisitions.)

## U.S. Water Services

Year Ended December 31	2017	2016
Millions		
Operating Revenue	\$151.8	\$137.5
Net Income Attributable to ALLETE (a)	\$10.7	\$1.5

(a) Results in 2017 include a \$9.2 million after-tax benefit due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA.

Operating Revenue increased \$14.3 million from 2016 primarily due to the acquisitions of WEST in October 2016 and Tonka Water in September 2017. (See Note 6. Acquisitions.) Revenue from chemical sales and related services was \$116.0 million in 2017 compared to \$110.5 million in 2016. Revenue from equipment sales was \$35.8 million for 2017 compared to \$27.0 million in 2016; equipment sales can significantly fluctuate from period to period.

Net Income Attributable to ALLETE increased \$9.2 million from 2016. Net income in 2017 included a \$9.2 million after tax benefit due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA, and higher operating revenue, partially offset by increased operating expenses as a result of investments for future growth in waste treatment and water safety applications. Net income in 2017 also included a net loss of \$0.8 million primarily for transaction fees and amortization expense of the Tonka Water acquisition on September 1, 2017. (See Note 6. Acquisitions.)

Cash flow from operations for U.S. Water Services was approximately \$12 million in 2017 compared to approximately \$11 million in 2016.

## Corporate and Other

Operating Revenue increased \$2.2 million, or 2 percent, from 2016 primarily due to an increase in revenue at BNI Energy, which operates under cost-plus fixed fee contracts, as a result of higher expenses and record coal sales in 2017, partially offset by a decrease in land sales at ALLETE Properties. Operating revenue in 2016 included the sale of ALLETE Properties' Ormond Crossings project and Lake Swamp wetland mitigation bank for approximately \$21 million.

ALLETE, Inc. 2017 Form 10-K

41

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2017 Compared to 2016 (Continued)  
Corporate and Other (Continued)

Net Loss Attributable to ALLETE was \$8.4 million in 2017 compared to net income of \$4.9 million in 2016. The net loss in 2017 included a \$19.8 million after-tax expense due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA. The net loss in 2017 also included a \$7.9 million after-tax favorable impact for the regulatory outcome of the MPUC's modification of its November 2016 order on the allocation of North Dakota investment tax credits, lower accretion expense relating to the contingent consideration liability, and lower interest expense. Net income in 2016 included an after tax gain of \$13.6 million related to the change in fair value of the contingent consideration liability, partially offset by an \$8.8 million after-tax adverse impact for the regulatory outcome of the November 2016 MPUC order.

Net income at BNI Energy was \$4.5 million in 2017 which included a \$3.1 million after-tax expense due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA, partially offset by more tons sold; net income in 2016 was \$6.8 million. The net loss at ALLETE Properties was \$8.8 million in 2017 which included a \$7.8 million after-tax expense for the remeasurement of deferred income tax assets and liabilities resulting from the TCJA; net income in 2016 was \$0.7 million.

Income Taxes – Consolidated

For the year ended December 31, 2017, the effective tax rate was 7.9 percent (11.3 percent for the year ended December 31, 2016). The decrease from 2016 was primarily due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA and increased production tax credits, partially offset by higher pre-tax income. (See Regulated Operations - Income Tax Expense.) The effective rate deviated from the combined statutory rate of approximately 41 percent primarily due to the remeasurement of deferred income tax assets and liabilities resulting from the TCJA, and production tax credits. (See Note 13. Income Tax Expense.)

2016 Compared to 2015

(See Note 17. Business Segments for financial results by segment.)

Regulated Operations

Year Ended December 31	2016	2015
Millions		
Operating Revenue – Utility	\$1,000.7	\$991.2
Fuel, Purchased Power and Gas – Utility	339.9	336.0
Transmission Services – Utility	65.2	54.1
Operating and Maintenance	220.7	229.6
Depreciation and Amortization	154.3	135.1
Taxes Other than Income Taxes	47.7	46.2
Operating Income	172.9	190.2
Interest Expense	(52.1)	(53.9)
Equity Earnings in ATC	18.5	16.3
Other Income	2.1	3.4
Income Before Income Taxes	141.4	156.0
Income Tax Expense	5.9	24.4
Net Income Attributable to ALLETE	\$135.5	\$131.6



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Operating Revenue – Utility increased \$9.5 million, or 1 percent, from 2015 primarily due to higher transmission revenue, cost recovery rider revenue, pricing on PSAs with Other Power Suppliers and FERC formula-based rates, partially offset by the adverse impact for the regulatory outcome of the November 2016 MPUC order related to the allocation of North Dakota investment tax credits as well as lower conservation improvement program recoveries.

Transmission revenue increased \$9.7 million primarily due to period over period changes in our estimate of a refund liability related to MISO return on equity complaints and higher MISO-related revenue. (See Operating Expenses - Transmission Services – Utility.)

ALLETE, Inc. 2017 Form 10-K

42

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2016 Compared to 2015 (Continued)

Regulated Operations (Continued)

Cost recovery rider revenue increased \$7.5 million primarily due to the completion of the Boswell Unit 4 environmental upgrade in the fourth quarter of 2015.

Despite lower kWh sales, revenue increased \$4.9 million from 2015 primarily due to higher pricing on PSAs with Other Power Suppliers in 2016. Sales to Other Power Suppliers are sold at market-based prices into the MISO market on a daily basis or through bilateral agreements of various durations. Sales to industrial customers decreased 2.7 percent primarily due to reduced taconite production. In addition, demand revenue from industrial customers was down in 2016 as a result of lower demand nominations.

	2016	2015	Quantity Variance	% Variance
Kilowatt-hours Sold				
Millions				
Regulated Utility				
Retail and Municipal				
Residential	1,102	1,113	(11)	(1.0)
Commercial	1,442	1,462	(20)	(1.4)
Industrial	6,456	6,635	(179)	(2.7)
Municipal	816	833	(17)	(2.0)
Total Retail and Municipal	9,816	10,043	(227)	(2.3)
Other Power Suppliers	4,316	4,310	6	0.1
Total Regulated Utility Kilowatt-hours Sold	14,132	14,353	(221)	(1.5)

Revenue from electric sales to taconite and iron concentrate customers accounted for 18 percent of consolidated operating revenue in 2016 (17 percent in 2015). Revenue from electric sales to paper, pulp and secondary wood product customers accounted for 6 percent of consolidated operating revenue in 2016 (6 percent in 2015). Revenue from electric sales to pipelines and other industrial customers accounted for 7 percent of consolidated operating revenue in 2016 (6 percent in 2015).

Revenue from wholesale customers under FERC formula-based rates increased \$3.8 million primarily due to additional environmental and other investments.

Revenue decreased \$15.0 million due to the adverse impact for the regulatory outcome of the November 2016 MPUC order related to the allocation of North Dakota investment tax credits. (See Note 4. Regulatory Matters.)

Conservation improvement program recoveries decreased \$4.1 million from 2015 primarily due to a reduction in related expenditures. (See Operating Expenses - Operating and Maintenance Expense.)

Operating Expenses increased \$26.8 million, or 3 percent, from 2015.

Fuel, Purchased Power and Gas – Utility expense increased \$3.9 million, or 1 percent, from 2015 primarily due to higher fuel and purchased power prices in 2016 compared to 2015, partially offset by lower kWh sales in 2016. Fuel and purchased power expense related to retail and municipal customers is recovered through the fuel adjustment clause.

Transmission Services – Utility expense increased \$11.1 million, or 21 percent, from 2015 primarily due to higher MISO related expense and period over period changes in our estimate of a refund for MISO transmission expense related to MISO return on equity complaints. (See Operating Revenue and Note 4. Regulatory Matters.)

Operating and Maintenance expense decreased \$8.9 million, or 4 percent, from 2015, primarily due to lower pension and other postretirement benefit expenses (see Note 15. Pension and Other Postretirement Benefit Plans), a \$3.6 million sales tax refund received in 2016 and a \$4.1 million decrease in conservation improvement program expenses. Conservation improvement program expenses are recovered from certain retail customers. (See Operating Revenue.) Operating and Maintenance expense included higher storm restoration costs of \$2.9 million related to severe wind storms across Minnesota Power's service territory in July 2016.

ALLETE, Inc. 2017 Form 10-K

43

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## 2016 Compared to 2015 (Continued)

## Regulated Operations (Continued)

Depreciation and Amortization expense increased \$19.2 million, or 14 percent, from 2015 primarily due to additional property, plant and equipment in service.

Taxes Other than Income Taxes increased \$1.5 million, or 3 percent, from 2015 primarily due to higher property tax expenses resulting from higher taxable plant.

Interest Expense decreased \$1.8 million, or 3 percent, from 2015 primarily due to lower average interest rates. We record interest expense for Regulated Operations based on Minnesota Power's rate base and authorized capital structure, and allocate the balance to Corporate and Other.

Equity Earnings in ATC increased \$2.2 million, or 13 percent, from 2015 primarily due to additional investments in ATC and period over period changes in ATC's estimate of a refund liability related to MISO return on equity complaints.

Other Income decreased \$1.3 million, or 38 percent, from 2015 primarily due to lower AFUDC–Equity.

Income Tax Expense decreased \$18.5 million, or 76 percent, from 2015 due to lower pre-tax income, higher production tax credits and the adverse impact for the regulatory outcome of the November 2016 MPUC order related to the allocation of North Dakota investment tax credits. (See Note 4. Regulatory Matters.)

As a result of the adverse impact for the regulatory outcome of the November 2016 MPUC order, Regulated Operations reduced operating revenue and recorded a corresponding regulatory liability for approximately \$15 million resulting in an income tax benefit of \$6.2 million in 2016. In addition, Regulated Operations recorded an income tax benefit of \$8.8 million for North Dakota investment tax credits transferred from Corporate and Other, resulting in no impact to net income for Regulated Operations. Corporate and Other recorded an offsetting income tax expense of \$8.8 million for the North Dakota investment tax credits transferred to Regulated Operations.

## ALLETE Clean Energy

Year Ended December 31,	2016	2015
Millions		
Operating Revenue	\$80.5	\$262.1
Net Income Attributable to ALLETE	\$13.4	\$29.9

Operating Revenue decreased \$181.6 million from 2015. Operating revenue in 2015 included the recognition of \$197.7 million in revenue for the construction of a wind energy facility sold to Montana-Dakota Utilities in 2015. Operating revenue in 2016 was positively impacted by additional revenue generated from the operations of wind energy facilities acquired in April and July 2015.

	Year Ended December 31,			
	2016		2015	
Production and Operating Revenue	kWh	Revenue	kWh	Revenue
Millions				
Wind Energy Facility				
Lake Benton	254.7	\$12.8	265.1	\$13.5
Storm Lake II	154.8	10.1	186.4	11.7
Condon	96.9	8.2	84.1	7.8

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Storm Lake I	222.3	11.6	230.7	12.1
Chanarambie/Viking	278.8	13.4	199.1	9.8
Armenia Mountain	268.2	24.4	111.6	9.5
Total Wind Energy Facilities	1,275.7	80.5	1,077.0	64.4
Development Fee (a)	—	—	—	197.7
Total Production and Operating Revenue	1,275.7	80.5	1,077.0	262.1

(a) 2015 included the recognition of \$162.9 million of cost of sales.

ALLETE, Inc. 2017 Form 10-K

44

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2016 Compared to 2015 (Continued)  
 ALLETE Clean Energy (Continued)

Net Income Attributable to ALLETE decreased \$16.5 million from 2015. Net income for 2015 included the recognition of profit of \$20.4 million after-tax for the construction of a wind energy facility sold to Montana-Dakota Utilities. In 2015, net income also included \$1.8 million after-tax expense in acquisition costs related to the Chanarambie/Viking and Armenia Mountain wind energy facilities. Net income in 2016 included a \$3.3 million after-tax non-cash goodwill impairment charge (see Note 1. Operations and Significant Accounting Policies) and a \$0.9 million after-tax expense related to the repayment of long-term debt. Earnings in 2016 were positively impacted by income generated from the operations of wind energy facilities acquired in April and July 2015.

U.S. Water Services

	Year Ended	Period
		February 10, 2015
	December 31, 2016	Through December 31, 2015
Millions		
Operating Revenue	\$137.5	\$119.8
Net Income Attributable to ALLETE	\$1.5	\$0.9

Operating Revenue increased \$17.7 million in 2016 compared to the period from February 10, 2015, to December 31, 2015. The results for 2015 reflect operations from the date of acquisition, February 10, 2015, through December 31, 2015, and therefore, do not reflect a full year. Revenue from chemical sales and related services was \$110.5 million in 2016 compared to \$92.5 million in 2015. Revenue from equipment sales was \$27.0 million for 2016 compared to \$27.3 million in 2015; equipment sales can significantly fluctuate from period to period.

Net Income Attributable to ALLETE increased \$0.6 million in 2016 compared to the period from February 10, 2015, to December 31, 2015. The results for 2015 reflect operations from the date of acquisition, February 10, 2015, through December 31, 2015, and therefore do not reflect a full year. Net income in 2015 included an additional \$1.9 million of after tax expense recognized as cost of sales related to purchase accounting for inventories and sales backlog which have been fully recognized as of December 31, 2016. Earnings in 2016 reflected increased investments in back office systems and support at U.S. Water Services as we create a platform for future growth.

Corporate and Other

Operating Revenue increased \$7.7 million, or 7 percent, from 2015 primarily due to an increase in land sales at ALLETE Properties, which sold its Ormond Crossings project and Lake Swamp wetland mitigation bank in 2016. The increase was partially offset by a decrease in revenue at BNI Energy, which operates under cost-plus fixed fee contracts, as a result of lower expenses and fewer tons sold in 2016 compared to 2015.

Net Income Attributable to ALLETE increased \$26.2 million from 2015. Net income in 2016 included an after-tax gain of \$13.6 million related to the change in fair value of the U.S. Water Services contingent consideration liability and increased land sales at ALLETE Properties, partially offset by an adverse impact of \$8.8 million after-tax for the regulatory outcome of the November 2016 MPUC order. (Regulated Operations - Income Tax Expense.) In 2015, the net loss included a \$22.3 million after-tax non-cash impairment charge relating to the real estate assets of ALLETE Properties and \$3.0 million after-tax expense in acquisition costs related to U.S. Water Services. Net income at BNI Energy increased to \$6.8 million in 2016 compared to \$6.7 million in 2015, and net income at ALLETE Properties

increased to \$0.7 million in 2016 compared to a net loss of \$23.3 million in 2015.

Income Taxes – Consolidated

For the year ended December 31, 2016, the effective tax rate was 15.2 percent (22.6 percent for the year ended December 31, 2015). The decrease from the year ended December 31, 2015, was primarily due to increased production tax credits in 2016 related to additional wind energy generation. The effective rate deviated from the combined statutory rate of approximately 41 percent primarily due to production tax credits. (See Note 13. Income Tax Expense.)

ALLETE, Inc. 2017 Form 10-K

45

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## Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make various estimates and assumptions that affect amounts reported in the Consolidated Financial Statements. These estimates and assumptions may be revised, which may have a material effect on the Consolidated Financial Statements. Actual results may differ from these estimates and assumptions. These policies are discussed with the Audit Committee of our Board of Directors on a regular basis. We believe the following policies are most critical to our business and the understanding of our results of operations.

**Regulatory Accounting.** Our regulated utility operations are accounted for in accordance with the accounting standards for the effects of certain types of regulation. These standards require us to reflect the effect of regulatory decisions in our financial statements. Regulatory assets represent incurred costs that have been deferred as they are probable for recovery in customer rates. Regulatory liabilities represent obligations to make refunds to customers and amounts collected in rates for which the related costs have not yet been incurred. The Company assesses quarterly whether regulatory assets and liabilities meet the criteria for probability of future recovery or deferral. This assessment considers factors such as, but not limited to, changes in the regulatory environment and recent rate orders to other regulated entities under the same jurisdiction. If future recovery or refund of costs becomes no longer probable, the assets and liabilities would be recognized in current period net income or other comprehensive income. (See Note 4. Regulatory Matters.)

**Pension and Postretirement Health and Life Actuarial Assumptions.** We account for our pension and other postretirement benefit obligations in accordance with the accounting standards for defined benefit pension and other postretirement plans. These standards require the use of several important assumptions, including the expected long-term rate of return on plan assets, the discount rate and mortality assumptions, among others, in determining our obligations and the annual cost of our pension and other postretirement benefits. In establishing the expected long-term rate of return on plan assets, we determine the long-term historical performance of each asset class and adjust these for current economic conditions while utilizing the target allocation of our plan assets to forecast the expected long-term rate of return. Our pension asset allocation as of December 31, 2017, was approximately 53 percent equity securities, 38 percent debt, 5 percent private equity and 4 percent real estate. Our postretirement health and life asset allocation as of December 31, 2017, was approximately 64 percent equity securities, 31 percent debt and 5 percent private equity. Equity securities consist of a mix of market capitalization sizes with domestic and international securities. In 2017, we used expected long-term rates of return of 7.50 percent in our actuarial determination of our pension expense and 6.00 percent to 7.50 percent in our actuarial determination of our other postretirement expense. The actuarial determination uses an asset smoothing methodology for actual returns to reduce the volatility of varying investment performance over time. We review our expected long-term rate of return assumption annually and will adjust it to respond to changing market conditions. A one quarter percent decrease in the expected long-term rate of return would increase the annual expense for pension and other postretirement benefits by approximately \$1.8 million, pre-tax.

The discount rate is computed using a bond matching study which utilizes a portfolio of high quality bonds that produce cash flows similar to the projected costs of our pension and other postretirement plans. In 2017, we used discount rates of 4.53 percent and 4.57 percent in our actuarial determination of our pension and other postretirement expense, respectively. We review our discount rates annually and will adjust them to respond to changing market conditions. A one-quarter percent decrease in the discount rate would increase the annual expense for pension and other postretirement benefits by approximately \$1.1 million, pre tax.

The mortality assumptions used to calculate our pension and other postretirement benefit obligations as of December 31, 2017, considered a modified RP-2014 mortality table and mortality projection scale. (See Note 15. Pension and Other Postretirement Benefit Plans.)



**Impairment of Long-Lived Assets.** We review our long-lived assets, which include the legacy real estate assets of ALLETE Properties, for indicators of impairment in accordance with the accounting standards for property, plant and equipment on a quarterly basis.

In accordance with the accounting standards for property, plant and equipment, if indicators of impairment exist, we test our long lived assets for recoverability by comparing the carrying amount of the asset to the undiscounted future net cash flows expected to be generated by the asset. Cash flows are assessed at the lowest level of identifiable cash flows. The undiscounted future net cash flows are impacted by trends and factors known to us at the time they are calculated and our expectations related to: management's best estimate of future sales prices; holding period and timing of sales; method of disposition; and future expenditures necessary to maintain the operations.

ALLETE, Inc. 2017 Form 10-K

46

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Critical Accounting Policies (Continued)

**Taxation.** We are required to make judgments regarding the potential tax effects of various financial transactions and our ongoing operations to estimate our obligations to taxing authorities. These tax obligations include income taxes and taxes other than income taxes. Judgments related to income taxes require the recognition in our financial statements of the largest tax benefit of a tax position that is “more-likely-than-not” to be sustained on audit. Tax positions that do not meet the “more-likely-than-not” criteria are reflected as a tax liability in accordance with the accounting standards for uncertainty in income taxes. We record a valuation allowance against our deferred tax assets to the extent it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized.

We are subject to income taxes in various jurisdictions. We make assumptions and judgments each reporting period to estimate our income tax assets, liabilities, benefits and expenses. Judgments and assumptions are supported by historical data and reasonable projections. Our assumptions and judgments include the application of tax statutes and regulations, and projections of future federal taxable income, state taxable income, and state apportionment to determine our ability to utilize NOL and credit carryforwards prior to their expiration. Significant changes in assumptions regarding future federal and state taxable income or a change in tax rates could require new or increased valuation allowances which could result in a material impact on our results of operations.

**Valuation of Goodwill and Intangible Assets.** When we acquire a business, the assets acquired and liabilities assumed are recorded at their respective fair values as of the acquisition date. Determining the fair value of intangible assets acquired as part of a business combination requires us to make significant estimates. These estimates include the amount and timing of projected future cash flows, the discount rate used to discount those cash flows to present value, the assessment of the asset’s life cycle, and the consideration of legal, technical, regulatory, economic and competitive risks. The fair value assigned to intangible assets is determined by estimating the future cash flows of each project and discounting the net cash flows back to their present values. The discount rate used is determined at the time of measurement in accordance with accepted valuation standards.

**Goodwill.** Goodwill is the excess of the purchase price (consideration transferred) over the estimated fair value of net assets of acquired businesses. In accordance with GAAP, goodwill is not amortized. The Company assesses whether there has been an impairment of goodwill annually in the fourth quarter and whenever an event occurs or circumstances change that would indicate the carrying amount may be impaired. Impairment testing for goodwill is done at the reporting unit level. An impairment loss is recognized when the carrying amount of the reporting unit’s net assets exceeds the estimated fair value of the reporting unit. The test for impairment requires us to make several estimates about fair value, most of which are based on projected future cash flows. Our estimates associated with the goodwill impairment test are considered critical due to the amount of goodwill recorded on our Consolidated Balance Sheet and the judgment required in determining fair value, including projected future cash flows. The results of our annual impairment test are discussed in Note 1. Operations and Significant Accounting Policies and Note 9. Fair Value in this Form 10-K. Goodwill was \$148.3 million and \$131.2 million as of December 31, 2017, and December 31, 2016, respectively.

**Intangible Assets.** Intangible assets include customer relationships, patents, non-compete agreements, land easements, trademarks and trade names. Intangible assets with definite lives consist of customer relationships, which are amortized using an attrition model, and patents, non-compete agreements, land easements and certain trade names, which are amortized on a straight-line basis with estimated useful lives ranging from approximately 1 year to approximately 20 years. We review definite-lived intangible assets for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Indefinite-lived intangible assets consist of trademarks and certain trade names, which are tested for impairment annually in the fourth quarter and whenever an event occurs or circumstances change that would indicate that the carrying amount may be impaired. Impairment is calculated as the excess of the asset’s carrying amount over its fair value. Our impairment reviews are based on an

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estimated future cash flow approach that requires significant judgment with respect to future revenue and expense growth rates, selection of an appropriate discount rate, and other assumptions and estimates. We use estimates that are consistent with our business plans and a market participant view of the assets being evaluated. The results of our annual impairment test are discussed in Note 9. Fair Value in this Form 10-K. Intangible assets, net of accumulated amortization, were \$77.6 million and \$82.2 million as of December 31, 2017, and December 31, 2016, respectively.

ALLETE, Inc. 2017 Form 10-K

47

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## Outlook

ALLETE is an energy company committed to earning a financial return that rewards our shareholders, allows for reinvestment in our businesses and sustains growth. The Company has long-term objectives of achieving average annual earnings per share growth of 5 percent to 7 percent, and providing a dividend payout competitive with our industry.

ALLETE is predominately a regulated utility through Minnesota Power, SWL&P and an investment in ATC. ALLETE's strategy is to remain predominately a regulated utility while investing in its Energy Infrastructure and Related Services businesses to complement its regulated businesses, balance exposure to the utility's industrial customers and provide potential long-term earnings growth. ALLETE expects net income from Regulated Operations to be approximately 80 percent of total consolidated net income in 2018. Over the next several years, the contribution of the Energy Infrastructure and Related Services businesses to net income is expected to increase as ALLETE grows these operations. ALLETE expects its businesses to provide regulated, contracted or recurring revenues, and to support sustained growth in net income and cash flow.

**Regulated Operations.** Minnesota Power's long-term strategy is to be the leading electric energy provider in northeastern Minnesota by providing safe, reliable and cost-competitive electric energy, while complying with environmental permit conditions and renewable energy requirements. Keeping the cost of energy production competitive enables Minnesota Power to effectively compete in the wholesale power markets and minimizes retail rate increases to help maintain customer viability. As part of maintaining cost competitiveness, Minnesota Power intends to reduce its exposure to possible future carbon and GHG legislation by reshaping its generation portfolio, over time, to reduce its reliance on coal. (See EnergyForward.) We will monitor and review proposed environmental regulations and may challenge those that add considerable cost with limited environmental benefit. Minnesota Power will continue to pursue customer growth opportunities and cost recovery rider approvals for transmission, renewable and environmental investments, as well as work with regulators to earn a fair rate of return.

**Regulatory Matters.** Entities within our Regulated Operations segment are under the jurisdiction of the MPUC, FERC, PSCW and NDPSC. See Note 4. Regulatory Matters for discussion of regulatory matters within these jurisdictions.

**2016 Minnesota General Rate Case.** In November 2016, Minnesota Power filed a retail rate increase request with the MPUC seeking an average increase of approximately 9 percent for retail customers. The rate filing sought a return on equity of 10.25 percent and a 53.81 percent equity ratio. On an annualized basis, the requested final rate increase would have generated approximately \$55 million in additional revenue. In December 2016, Minnesota Power filed a request to modify its original interim rate proposal reducing its requested interim rate increase to \$34.7 million from the original request of approximately \$49 million due to a change in its electric sales forecast. In December 2016 orders, the MPUC accepted the November 2016 filing as complete and authorized an annual interim rate increase of \$34.7 million beginning January 1, 2017.

On February 23, 2017, Minnesota Power filed an additional request to further reduce its requested interim rate increase. In an order dated April 13, 2017, the MPUC approved Minnesota Power's updated retail rate request resulting in a reduction in the annual interim rate increase to \$32.2 million beginning May 1, 2017. As a result of working with intervenors and further developments as the rate review progressed, Minnesota Power's final rate request was adjusted to approximately \$49 million on an annualized basis. At a hearing on January 18, 2018, the MPUC made determinations regarding Minnesota Power's general rate case including allowing a return on common equity of 9.25 percent and a 53.81 percent equity ratio. Upon commencement of final rates, we expect additional revenue of approximately \$13 million on an annualized basis. Final rates are expected to commence in the fourth quarter of 2018; interim rates will be collected through this period which will be fully offset by the recognition of a corresponding reserve. As a result of the MPUC's decisions on January 18, 2018, Minnesota Power has recorded a reserve for an

interim rate refund of approximately \$32 million as of December 31, 2017. The MPUC also disallowed recovery of Minnesota Power's regulatory asset for deferred fuel adjustment clause costs due to the anticipated adoption of a forward-looking fuel adjustment clause methodology resulting in a \$19.5 million pre-tax charge to Fuel, Purchased Power and Gas – Utility in 2017. An order from the MPUC setting forth the effective date of final rates is expected by March 12, 2018. Minnesota Power will review this order for potential reconsideration of certain issues at that time.

As part of its decision in Minnesota Power's 2016 general rate case, the MPUC extended the depreciable lives of Boswell Unit 3, Unit 4 and common facilities to 2050 primarily to mitigate rate increases for our customers, and shortened the depreciable lives of Boswell Unit 1 and Unit 2 to 2022, resulting in a decrease to depreciation expense of approximately \$25 million pre-tax in 2017.

ALLETE, Inc. 2017 Form 10-K

48

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Outlook (Continued)

Regulatory Matters (Continued)

**Energy-Intensive Trade-Exposed Customer Rates.** An EITE customer ratemaking law was enacted in 2015 which established that it is the energy policy of Minnesota to have competitive rates for certain industries such as mining and forest products. In 2015, Minnesota Power filed a rate schedule petition with the MPUC for EITE customers and a corresponding rider for EITE cost recovery. In a March 2016 order, the MPUC dismissed the petition without prejudice. In June 2016, Minnesota Power filed a revised EITE petition with the MPUC which included additional information on the net benefits analysis, limits on eligible customers and term lengths for the EITE discount. The rate adjustments were intended to be revenue and cash flow neutral to Minnesota Power. The MPUC approved a reduction in rates for EITE customers in a December 2016 order and subsequently approved cost recovery in an order dated April 20, 2017; collection of the discount was subject to the MPUC's review of Minnesota Power's compliance filing implementing approval of a recovery mechanism, with the subsequent order issued on October 13, 2017, that modified the order dated April 20, 2017. During 2017, Minnesota Power provided discounts of \$8.6 million which were recorded as a receivable. On September 29, 2017, Minnesota Power informed its EITE customers that it had suspended the EITE discount due to a concern that it was not revenue and cash flow neutral to Minnesota Power based on an MPUC decision at a hearing on September 7, 2017, as well as the interim rate reduction and decisions in its 2016 general rate case. Based on the MPUC's decisions at a hearing on January 18, 2018, as part of Minnesota Power's 2016 general rate case, Minnesota Power reinstated the EITE discount effective January 1, 2018. Minnesota Power expects the discount to EITE customers to be approximately \$15 million annually based on EITE customer current operating levels. While interim rates are in effect for Minnesota Power's 2016 general rate case, EITE discounts will offset interim rate refund reserves for non-EITE customers.

**2016 Wisconsin General Rate Case.** SWL&P's current retail rates are based on a 2017 PSCW retail rate order effective August 14, 2017, that allows for a 10.5 percent return on common equity and a 55 percent equity ratio. SWL&P's retail rates prior to August 14, 2017, were based on a 2012 PSCW retail rate order that provided for a 10.9 percent return on equity. The 2017 PSCW retail rate order authorizes SWL&P to collect on average a 2.9 percent increase in rates for retail customers (3.8 percent increase in electric rates; 4.8 percent decrease in natural gas rates; and 9.8 percent increase in water rates). On an annualized basis, SWL&P expects to collect additional revenue of \$2.5 million.

**Industrial Customers and Prospective Additional Load**

**Industrial Customers.** Electric power is one of several key inputs in the taconite mining, iron concentrate, paper, pulp and secondary wood products, pipeline and other industries. Approximately 50 percent of our regulated utility kWh sales in 2017 (45 percent in 2016 and 46 percent in 2015) were made to our industrial customers. We expect industrial sales of approximately 7.0 million to 7.5 million MWh in 2018 (7.3 million MWh in 2017; 6.5 million MWh in 2016).

**Taconite and Iron Concentrate.** Minnesota Power's taconite customers are capable of producing up to approximately 41 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 has been 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. These iron concentrate facilities are owned in whole, or in part, by ERP Iron Ore and are currently idled. (See ERP Iron Ore / Magnetation.)

There has been a general historical correlation between U.S. steel production and Minnesota taconite production. The American Iron and Steel Institute, an association of North American steel producers, reported that U.S. raw steel

production operated at approximately 74 percent of capacity in 2017 (71 percent in 2016 and in 2015). The World Steel Association, an association of over 160 steel producers, national and regional steel industry associations, and steel research institutes representing approximately 85 percent of world steel production, projected U.S. steel consumption in 2018 will increase by approximately 1 percent compared to 2017.

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 \$0.04, net of expected power marketing sales at current prices. Changes in wholesale electric prices or customer contractual demand nominations could impact this estimate. Minnesota Power proactively sells power in the wholesale power markets that is temporarily not required by industrial customers to optimize the value of its generating facilities. Long-term reductions in taconite production or a permanent shut down of a taconite customer may lead Minnesota Power to file a general rate case to recover lost revenue.

ALLETE, Inc. 2017 Form 10-K

49

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Outlook (Continued)

Industrial Customers and Prospective Additional Load (Continued)

USS Corporation. In 2015, USS Corporation temporarily idled its Minnesota Ore Operations - Keetac plant in Keewatin, Minnesota, and a portion of its Minnesota Ore Operations - Minntac plant in Mountain Iron, Minnesota. These actions were due to high inventory levels and ongoing adjustment of its steel producing operations throughout North America. Global influences in the market, including a higher level of imports, unfairly traded products and reduced steel prices, were cited as having an impact. USS Corporation returned its Minntac plant to full production in 2015, and in the first quarter of 2017, USS Corporation restarted its Keetac plant. USS Corporation has the capability to produce approximately 5 million tons and 15 million tons of taconite annually at its Keetac and Minntac plants, respectively.

United Taconite. On May 16, 2017, Cliffs announced that production of a fully fluxed taconite pellet has started at its United Taconite facility. The product replaces a flux pellet previously made at Cliffs' indefinitely idled Empire operation in Michigan. United Taconite has the capability to produce approximately 5 million tons of taconite annually.

Northshore Mining. Cliffs has announced that it is investing further in Minnesota ore operations, specifically it plans to invest approximately \$75 million through 2020 to expand capacity for producing direct reduced-grade pellets at Northshore Mining. The additional direct reduced-grade pellets could be sold commercially or used to supply Cliff's planned hot briquetted iron production plant in Toledo, Ohio. Minnesota Power has a long-term PSA through 2031 with Silver Bay Power, which provides the majority of the electric service requirements for Northshore Mining. (See Silver Bay Power.)

Silver Bay Power. In 2016, Minnesota Power and Silver Bay Power entered into a long-term PSA through 2031. Silver Bay Power supplies approximately 90 MW of load to Northshore Mining, an affiliate of Silver Bay Power, which has been served predominately through self-generation by Silver Bay Power. In the years 2016 through 2019, Minnesota Power is supplying Silver Bay Power with at least 50 MW of energy and Silver Bay Power has the option to purchase additional energy from Minnesota Power as it transitions away from self-generation. On December 31, 2019, Silver Bay Power will cease self-generation and Minnesota Power will supply the energy requirements for Silver Bay Power.

ERP Iron Ore / Magnetation. In 2015, Magnetation announced that it had filed voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court for the District of Minnesota, citing the significant decrease in global iron ore prices and its existing capital structure. In January 2016, Magnetation idled its Plant 2 facility in Bovey, Minnesota. In October 2016, the bankruptcy court approved plans to idle Magnetation's Plant 4 facility near Grand Rapids, Minnesota, and its pellet plant in Reynolds, Indiana, as well as terminate Magnetation's pellet purchase agreement with AK Steel Corporation. The company subsequently idled the facilities and stated it was preserving the plants and their value for a potential buyer. On January 30, 2017, ERP Iron Ore purchased substantially all of Magnetation's assets pursuant to an asset purchase agreement approved by the bankruptcy court. Although we cannot predict whether the facilities will be restarted, Minnesota Power would serve the Plant 2 and Plant 4 facilities through ERP Iron Ore's assumption of the existing electric service agreement.

Paper, Pulp and Secondary Wood Products. Minnesota Power serves a number of customers in the paper, pulp and secondary wood products industry. The four major paper and pulp mills we serve reported operating at, or near, full capacity in 2017. Lower levels of production are expected in 2018 as a result of the closure of the smaller of the two paper machines located at UPM Blandin in the fourth quarter of 2017. (See UPM Blandin.)



UPM Blandin. On October 24, 2017, UPM-Kymmene Corporation announced that in light of the global market situation for graphic papers, and to sustain its competitiveness and leading position in the market, it planned to permanently close the smaller of UPM Blandin's two paper machines located in Grand Rapids, Minnesota; the closure was completed in the fourth quarter of 2017. Paper production related to the other paper machine is planned to continue at UPM Blandin. Minnesota Power provides electric and steam service to UPM Blandin.

Prospective Additional Load. Minnesota Power is pursuing new wholesale and retail loads in and around its service territory. Currently, several companies in northeastern Minnesota continue to progress in the development of natural resource-based projects that represent long-term growth potential and load diversity for Minnesota Power. We cannot predict the outcome of these projects.

Nashwauk Public Utilities Commission. Mesabi Metallics is a retail customer of the Nashwauk Public Utilities Commission, and Minnesota Power has a wholesale electric contract with the Nashwauk Public Utilities Commission for electric service through at least December 2032. Mesabi Metallics filed for bankruptcy protection in July 2016, under Chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware. On June 13, 2017, the bankruptcy court approved a settlement plan for a consortium led by Chippewa Capital Partners LLC to take control of the project, subject to certain stipulations. On December 22, 2017, Mesabi Metallics emerged from bankruptcy under the ownership of Chippewa Capital Partners LLC.

ALLETE, Inc. 2017 Form 10-K

50

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Outlook (Continued)

Industrial Customers and Prospective Additional Load (Continued)

**PolyMet.** PolyMet is planning to start a new copper-nickel and precious metal (non-ferrous) mining operation in northeastern Minnesota. In 2015, PolyMet announced the completion of the final EIS by state and federal agencies, which was subsequently published in the Federal Register and Minnesota Environmental Quality Board Monitor. The Minnesota Department of Natural Resources (DNR) issued its Record of Decision in March 2016, finding the final EIS adequate. In July 2016, PolyMet submitted applications for water-related permits with the State of Minnesota, and in August 2016, an application for an air quality permit was submitted to the MPCA. In November 2016, PolyMet submitted a state permit to mine application to the DNR detailing its operational plans for the mine. On January 5, 2018, the DNR released PolyMet's draft permit to mine and opened a public comment period through March 6, 2018. Public hearings were held in February 2018 to review the draft permit to mine, as well as the MPCA's recently released draft water quality permit, draft air quality permit and draft water quality certification. The final EIS also requires Records of Decision by the federal agencies, which are expected in 2018, before final action can be taken on the required federal permits to construct and operate the mining operation. On January 9, 2017, the U.S. Forest Service signed the Final Record of Decision authorizing a land exchange with PolyMet, which upon completion of title transfer will result in PolyMet obtaining surface rights to land needed to develop its mining operation. Minnesota Power could supply between 45 MW and 50 MW of load under a ten-year power supply contract with PolyMet that would begin upon start-up of operations.

**EnergyForward.** Minnesota Power is executing EnergyForward, a strategic plan for assuring reliability, protecting affordability and further improving environmental performance. The plan includes completed and planned investments in wind, solar, natural gas and hydroelectric power, construction of additional transmission capacity, the installation of emissions control technology and the idling of certain coal-fired generating facilities.

On July 28, 2017, Minnesota Power submitted a resource package to the MPUC requesting approval of PPAs for the output of a 250 MW wind energy facility and a 10 MW solar energy facility as well as approval of a 250 MW natural gas energy PPA. These agreements will be subject to MPUC approval of the construction of a 525 MW to 550 MW combined-cycle natural gas-fired generating facility which will be jointly owned by Dairyland Power Cooperative and a subsidiary of ALLETE. Minnesota Power would purchase approximately 50 percent of the facility's output starting in 2025. In an order dated September 19, 2017, the MPUC approved Minnesota Power's request that approval for the natural gas energy PPA be decided through an administrative law judge process. The administrative law judge is expected to provide a recommendation by July 2018, and the Company anticipates a MPUC decision in the second half of 2018. The MPUC did not take any action regarding the wind and solar energy PPAs which will be refiled separately from the natural gas energy PPA.

**Integrated Resource Plan.** In 2015, Minnesota Power filed its 2015 IRP with the MPUC which contained steps in its EnergyForward strategic plan, and included an analysis of a variety of existing and future energy resource alternatives and a projection of customer cost impact by class. In a July 2016 order, the MPUC approved Minnesota Power's 2015 IRP with modifications. The order accepted Minnesota Power's plans for Taconite Harbor, directed Minnesota Power to retire Boswell Units 1 and 2 no later than 2022, required an analysis of generation and demand response alternatives to be filed with a natural gas resource proposal, and required Minnesota Power to conduct request for proposals for additional wind, solar and demand response resource additions subject to further MPUC approvals. In October 2016, Minnesota Power announced that Boswell Units 1 and 2 will be retired in 2018 as part of its EnergyForward strategic plan. In an order dated September 19, 2017, the MPUC approved Minnesota Power's request to extend the next IRP filing deadline until October 1, 2019. (See Note 4. Regulatory Matters.)

**Renewable Energy.** Minnesota Power's 2015 IRP includes an update on its plans and progress in meeting the Minnesota renewable energy milestones through 2025. Minnesota Power continues to execute its renewable energy

strategy through renewable projects that will ensure it meets the identified state mandate at the lowest cost for customers. Minnesota Power has exceeded the interim milestone requirements to date and expects 28 percent of its applicable retail and municipal energy sales will be supplied by renewable energy sources in 2018. (See Item 1. Business – Regulated Operations – Minnesota Legislation and EnergyForward.)

ALLETE, Inc. 2017 Form 10-K

51

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Outlook (Continued)  
EnergyForward (Continued)

Minnesota Solar Energy Standard. Minnesota law requires at least 1.5 percent of total retail electric sales, excluding sales to certain customers, to be generated by solar energy by the end of 2020. At least 10 percent of the 1.5 percent mandate must be met by solar energy generated by or procured from solar photovoltaic devices with a nameplate capacity of 40 kW or less and community solar garden subscriptions. In a 2016 order, the MPUC approved Camp Ripley, a 10 MW utility scale solar project at the Camp Ripley Minnesota Army National Guard base and training facility near Little Falls, Minnesota, as eligible to meet the solar energy standard and for current cost recovery. Camp Ripley was completed in the fourth quarter of 2016. In a July 2016 order, the MPUC approved a community solar garden project in northeastern Minnesota, which is comprised of a 1 MW solar array owned and operated by a third party with the output purchased by Minnesota Power and a 40 kW solar array that is owned and operated by Minnesota Power. Minnesota Power believes Camp Ripley and the community solar garden arrays will meet approximately one-third of the overall mandate. Additionally, in an order dated February 10, 2017, the MPUC approved Minnesota Power's proposal to increase the amount of solar rebates available for customer-sited solar installations and recover costs of the program through Minnesota Power's renewable cost recovery rider. The proposal to incentivize customer-sited solar installations and the community solar garden subscriptions is expected to meet a portion of the required small scale solar mandate.

Minnesota Power has approval for current cost recovery of investments and expenditures related to compliance with the Minnesota Solar Energy Standard. Currently, there is no approved customer billing rate for solar costs.

Wind Energy. Minnesota Power's wind energy facilities consist of Bison (497 MW) located in North Dakota and Taconite Ridge (25 MW) located in northeastern Minnesota. Minnesota Power also has two long-term wind energy PPAs with an affiliate of NextEra Energy, Inc. to purchase the output from Oliver Wind I (50 MW) and Oliver Wind II (48 MW) located in North Dakota.

Minnesota Power uses the 465-mile, 250-kV DC transmission line that runs from Center, North Dakota, to Duluth, Minnesota, to transport increasing amounts of wind energy from North Dakota while gradually phasing out coal-based electricity delivered to its system over this transmission line from Square Butte's lignite coal-fired generating unit. The DC transmission line capacity can be increased if renewable energy or transmission needs justify investments to upgrade the line.

Updated customer billing rates for the renewable cost recovery rider, which includes investments and expenditures related to Bison, were approved by the MPUC in an order dated November 8, 2017, which allows Minnesota Power to charge retail customers on a current basis for the costs of constructing certain renewable investments plus a return on the capital invested.

In a November 2016 order, the MPUC directed Minnesota Power to attribute all North Dakota investment tax credits realized from Bison to Minnesota Power regulated retail customers. As a result of the adverse regulatory outcome, Minnesota Power recorded a regulatory liability, and a reduction in Operating Revenue of approximately \$15 million in 2016. The North Dakota investment tax credits previously recognized as income tax credits in Corporate and Other were reversed in 2016 resulting in an \$8.8 million charge to net income in 2016. In December 2016, Minnesota Power submitted a request for reconsideration with the MPUC. In an order dated February 14, 2017, the MPUC decided to reconsider its November 2016 order.

In an order dated December 7, 2017, the MPUC modified its November 2016 order to allow Minnesota Power to account for North Dakota investment tax credits based on the long-standing regulatory precedents of stand-alone allocation methodology of accounting for income taxes. As a result of the favorable regulatory outcome, Minnesota

Power recorded a reduction in its regulatory liability and an increase in Operating Revenue of approximately \$14 million in 2017. The North Dakota investment tax credits were reestablished as income tax credits in Corporate and Other, resulting in a \$7.9 million increase to net income in 2017.

The stand-alone method provides that income taxes (and credits) are calculated as if Minnesota Power was the only entity included in ALLETE's consolidated federal and unitary state income tax returns. Minnesota Power has recorded a regulatory liability for North Dakota investment tax credits generated by its jurisdictional activity and expected to be realized in the future. North Dakota investment tax credits attributable to ALLETE's apportionment and income of ALLETE's other subsidiaries are included in Corporate and Other operations.

ALLETE, Inc. 2017 Form 10-K

52

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Outlook (Continued)

EnergyForward (Continued)

Tenaska PPA. On May 10, 2017, Minnesota Power and an affiliate of Tenaska signed a long-term PPA that provides for Minnesota Power to purchase the energy and associated capacity from a 250 MW wind energy facility in southwest Minnesota for a 20-year period beginning in 2020. The agreement provides for the purchase of output from the facility at fixed energy prices. There are no fixed capacity charges, and Minnesota Power will only pay for energy as it is delivered. This agreement is subject to MPUC approval of the construction of a 525 MW to 550 MW combined-cycle natural gas-fired generating facility which will be jointly owned by Dairyland Power Cooperative and a subsidiary of ALLETE, and construction of the wind energy facility. (See Note 4. Regulatory Matters.)

Manitoba Hydro. Minnesota Power has five long-term PPAs with Manitoba Hydro. The first PPA expires in May 2020. Under this agreement, Minnesota Power is purchasing 50 MW of capacity and the energy associated with that capacity. Both the capacity price and the energy price are adjusted annually by the change in a governmental inflationary index. Under the second PPA, Minnesota Power is purchasing surplus energy through April 2022. This energy-only agreement primarily consists of surplus hydro energy on Manitoba Hydro's system that is delivered to Minnesota Power on a non-firm basis. The pricing is based on forward market prices. Under this agreement, Minnesota Power will purchase at least one million MWh of energy over the contract term.

The third PPA provides for Minnesota Power to purchase 250 MW of capacity and energy from Manitoba Hydro for 15 years beginning in 2020. The agreement is subject to construction of additional transmission capacity between Manitoba and the U.S., along with construction of new hydroelectric generating capacity in Manitoba. (See Item 1. Business – Regulated Operations – Transmission and Distribution – Great Northern Transmission Line.) The capacity price is adjusted annually until 2020 by the change in a governmental inflationary index. The energy price is based on a formula that includes an annual fixed price component adjusted for the change in a governmental inflationary index and a natural gas index, as well as market prices.

The fourth PPA provides for Minnesota Power to purchase up to 133 MW of energy from Manitoba Hydro for 20 years beginning in 2020. The pricing under this PPA is based on forward market prices. The PPA is subject to the construction of the GNTL. (See Item 1. Business – Regulated Operations – Transmission and Distribution – Great Northern Transmission Line.)

The fifth PPA provides for Minnesota Power to purchase 50 MW of capacity from Manitoba Hydro at fixed prices. The PPA began in June 2017 and expires in May 2020.

Transmission. We continue to make investments in transmission opportunities that strengthen or enhance the transmission grid or take advantage of our geographical location between sources of renewable energy and end users. These include the GNTL, investments to enhance our own transmission facilities, investments in other transmission assets (individually or in combination with others), and our investment in ATC. See also Item 1. Business – Regulated Operations.

Energy Infrastructure and Related Services.

ALLETE Clean Energy.

ALLETE Clean Energy 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 is contracted under PSAs of various durations. ALLETE Clean Energy also engages in the development of wind energy facilities to operate under long-term PSAs or for sale to others upon completion.

ALLETE Clean Energy believes the market for renewable energy in North America is robust, driven by several factors including environmental regulation, tax incentives, societal expectations and continual technology advances. State renewable portfolio standards, and state or federal regulations to limit GHG emissions are examples of environmental regulation or public policy that we believe will drive renewable energy development.

ALLETE Clean Energy's strategy includes the safe, reliable, optimal and profitable operation of its existing facilities. This includes a strong safety culture, the continuous pursuit of operational efficiencies at existing facilities and cost controls. ALLETE Clean Energy generally acquires facilities in liquid power markets and its strategy includes the exploration of PSA extensions upon expiration of existing contracts.

ALLETE, Inc. 2017 Form 10-K

53

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## Outlook (Continued)

## ALLETE Clean Energy (Continued)

ALLETE Clean Energy will pursue growth through acquisitions or project development for others. ALLETE Clean Energy is targeting acquisitions of existing facilities up to 200 MW each, which have long-term PSAs in place for the facilities' output. At this time, ALLETE Clean Energy expects acquisitions will be primarily wind or solar facilities in North America. ALLETE Clean Energy is also targeting the development of new facilities up to 200 MW each, which will have long-term PSAs in place for the output or may be sold upon completion.

Federal production tax credit qualification is important to development project economics, and ALLETE Clean Energy invested in equipment in late 2016 and late 2017 to meet production tax credit safe harbor provisions which provides an opportunity to seek development of up to approximately 1,500 MW of qualified wind projects through 2021. ALLETE Clean Energy will also invest approximately \$80 million through 2020 to requalify up to 385 WTGs at its Storm Lake I, Storm Lake II and Lake Benton wind energy facilities for production tax credits. We anticipate annual production tax credits relating to these projects of approximately \$5 million in 2018, \$10 million in 2019, \$15 million to \$20 million annually in 2020 through 2027 and decreasing thereafter through 2030.

On January 3, 2017, ALLETE Clean Energy announced that it will develop a wind energy facility of up to 50 MW after securing a 25-year PSA with Montana-Dakota Utilities, which includes an option to purchase the facility upon completion. We expect Montana-Dakota Utilities to exercise the option in the first quarter of 2018; construction and sale is expected to be completed in December 2018. Revenue is expected to be recognized upon completion; if the wind energy facility is not completed and sold in 2018, revenue and related margins would be recognized in 2019. ALLETE Clean Energy constructed and sold a 107 MW wind energy facility to Montana-Dakota Utilities in 2015. On March 16, 2017, ALLETE Clean Energy announced it will build, own and operate a separate 100 MW wind energy facility pursuant to a 20-year PSA with Northern States Power; construction is expected to begin in late 2018.

ALLETE Clean Energy manages risk by having a diverse portfolio of assets, which includes PSA expiration, technology and geographic diversity. The current portfolio of approximately 535 MW is subject to typical variations in seasonal wind with higher wind resources typically available in the winter months. The majority of its planned maintenance leverages this seasonality and is performed during lower wind periods. The current mix of PSA expiration and geographic location for existing facilities is as follows:

Wind Energy Facility	Location	Capacity MW	PSA MW	PSA Expiration
Armenia Mountain	Pennsylvania	100.5	100%	2024
Chanarambie/Viking	Minnesota	97.5		
PSA 1			12%	2018
PSA 2			88%	2023
Condon	Oregon	50		