FORM 10-K

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

(Mark One)

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

For the fiscal year ended **December 31, 2003**

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

For the transition period from _____ to _____

Commission File No. 1-3548

ALLETE, Inc.

(Exact name of registrant as specified in its charter)

Minnesota	**41-0418150**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(218) 279-5000
(Registrant's telephone number, including area code)

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

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

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

None

Indicate by check mark 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 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 an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes ☑ No ☐

The aggregate market value of voting stock held by nonaffiliates on June 30, 2003 was $2,281,896,734.

As of March 8, 2004 there were 87,880,279 shares of ALLETE Common Stock, without par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2004 Annual Meeting of Shareholders are incorporated by reference in Part III.

TABLE OF CONTENTS

DEFINITIONS

Abbreviation or Acronym	Term
ACE	ACE Limited
ADESA Impact	Automotive Recovery Services, Inc. and Impact Auto, collectively
AFC	Automotive Finance Corporation
ALLETE	ALLETE, Inc. and its subsidiaries
APB	Accounting Principles Board
BNI Coal	BNI Coal, Ltd.
Boswell	Boswell Energy Center
Capital Re	Capital Re Corporation
CIP	Conservation Improvement Program(s)
Company	ALLETE, Inc. and its subsidiaries
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization Expense
EITF	Emerging Issues Task Force
Enventis Telecom	Enventis Telecom, Inc.
EPA	Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Florida Water	Florida Water Services Corporation
Form 8-K	ALLETE Current Report on Form 8-K
Form 10-K	ALLETE Annual Report on Form 10-K
Form 10-Q	ALLETE Quarterly Report on Form 10-Q
FPSC	Florida Public Service Commission
GAAP	Generally Accepted Accounting Principles in the United States
GeoInsight	GeoInsight, Inc.
Hibbard	M.L. Hibbard Station
Impact Auto	Impact Auto Auctions Ltd. and Suburban Auto Parts Inc., collectively
Invest Direct	ALLETE's Direct Stock Purchase and Dividend Reinvestment Plan
kWh	Kilowatthour(s)
kV	Kilovolt(s)
Laskin	Laskin Energy Center
Lehigh	Lehigh Acquisition Corporation
LIBOR	London Interbank Offer Rate
LTV	LTV Steel Mining Co.
MAPP	Mid-Continent Area Power Pool
MBtu	Million British thermal units
Minnesota Power	An operating division of ALLETE, Inc.
Minnkota Power	Minnkota Power Cooperative, Inc.
MISO	Midwest Independent Transmission System Operator, Inc.
MPCA	Minnesota Pollution Control Agency
MPUC	Minnesota Public Utilities Commission
MTBE	Methyl Tertiary-Butyl Ether
MW	Megawatt(s)
MWh	Megawatthour(s)
NCUC	North Carolina Utilities Commission
Note ___	Note ___ to the consolidated financial statements indexed in Item 15(a) of this Form 10-K
NPDES	National Pollutant Discharge Elimination System
NRG Energy	NRG Energy, Inc.
PSCW	Public Service Commission of Wisconsin
QUIPS	Quarterly Income Preferred Securities
Rainy River Energy	Rainy River Energy Corporation
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards No.
Split Rock Energy	Split Rock Energy LLC
Square Butte	Square Butte Electric Cooperative
SWL&P	Superior Water, Light and Power Company
Taconite Harbor	Taconite Harbor Energy Center
WDNR	Wisconsin Department of Natural Resources
WPPI	Wisconsin Public Power, Inc.

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

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are hereby filing cautionary statements identifying important factors that could cause our actual results to differ materially from those projected in forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) made by or on behalf of ALLETE in this Annual Report on Form 10-K, in presentations, in response to questions or otherwise. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "will likely result," "will continue" or similar expressions) are not statements of historical facts and may be forward-looking.

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

- our ability to successfully implement our strategic objectives, including the completion and impact of the proposed spin-off of our Automotive Services business and the sale of our Water Services businesses;
- war and acts of terrorism;
- prevailing governmental policies and regulatory actions, including those of the United States Congress, Canadian federal government, state and provincial legislatures, the FERC, the MPUC, the FPSC, the NCUC, the PSCW, and various county regulators and city administrators, about allowed rates of return, financings, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities, recovery of purchased power and capital investments, and present or prospective wholesale and retail competition (including but not limited to transmission costs) as well as vehicle-related laws, including vehicle brokerage and auction laws;
- unanticipated effects of restructuring initiatives in the electric and automotive industries;
- economic and geographic factors, including political and economic risks;
- changes in and compliance with environmental and safety laws and policies;
- weather conditions;
- natural disasters;
- market factors affecting supply and demand for used vehicles;
- wholesale power market conditions;
- population growth rates and demographic patterns;
- the effects of competition, including competition for retail and wholesale customers, as well as sellers and buyers of vehicles;
- pricing and transportation of commodities;
- changes in tax rates or policies or in rates of inflation;
- unanticipated project delays or changes in project costs;
- unanticipated changes in operating expenses and capital expenditures;
- capital market conditions;
- competition for economic expansion or development opportunities;
- our ability to manage expansion and integrate acquisitions; and
- the outcome of legal and administrative proceedings (whether civil or criminal) and settlements that affect the business and profitability of ALLETE.

Additional disclosures regarding factors that could cause our results and performance to differ from results or performance anticipated by this report are discussed in Item 7. under the heading "Factors that May Affect Future Results" located on page 46 of this Form 10-K. Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which that statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for management to predict all of these factors, nor can it assess the impact of each of these factors on the businesses of ALLETE or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement. Readers are urged to carefully review and consider the various disclosures made by us in this Form 10-K and in our other reports filed with the SEC that attempt to advise interested parties of the factors that may affect our business.

Item 1. Business

ALLETE has been incorporated under the laws of Minnesota since 1906. References in this report to "we," "us" and "our" are to ALLETE and its subsidiaries, collectively.

ALLETE files annual, quarterly and other reports and information with the SEC. You can read and copy any information filed by ALLETE with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. You can obtain additional information about the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including ALLETE. ALLETE also maintains an Internet site (www.allete.com) that contains documents as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

As of December 31, 2003 we had approximately 13,000 employees, 4,000 of which were part time. Our core operations in 42 states, nine Canadian provinces and Mexico focus on two segments: **Energy Services** which includes electric and gas services, coal mining and telecommunications; and **Automotive Services** which includes wholesale vehicle auctions and related vehicle redistribution services and dealer financing.

Investments and Corporate Charges include our real estate operations, investments in emerging technologies related to the electric utility industry and corporate charges. Corporate charges represent general corporate expenses, including interest, not specifically related to any one business segment.

For a detailed discussion of results of operations and trends, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. For business segment information, see Notes 1 and 2.

Spin-Off of Automotive Services. After a lengthy review of our strategic alternatives, in October 2003 we announced plans to spin off to ALLETE shareholders our Automotive Services business which would become a publicly traded company doing business as ADESA. The decision reflects our intention to maximize the long-term value of each business by creating two separate, more focused companies, and create long-term shareholder value. The spin-off is expected to take the form of a tax-free stock dividend to ALLETE's shareholders, who would receive one ADESA share for each share of ALLETE stock they own.

Our Energy Services and Automotive Services businesses are two very distinct businesses and we believe that this spin-off will better facilitate the strategic objectives of both businesses. We believe that our Automotive Services business will be better able to pursue a business growth strategy as an independent company. For ALLETE, we believe the spin-off will create a simplified regulatory and risk profile and a more stable credit rating, which will enhance our ability to pursue strategic growth initiatives.

Year Ended December 31	2003	2002	2001
Consolidated Operating Revenue — Millions	$1,619	$1,494	$1,526
Percentage of Consolidated Operating Revenue			
Energy Services			
Regulated Utility			
Industrial			
Taconite Producers	9%	10%	10%
Paper and Wood Products	4	4	4
Pipelines and Other Industries	2	3	3
Total Industrial	15	17	17
Residential	5	5	4
Commercial	5	5	5
Wholesale	5	5	6
Other Revenue	2	2	3
Total Regulated Utility	32	34	35
Nonregulated	9	8	5
Total Energy Services	41	42	40
Automotive Services	57	56	55
Investments	2	2	5
	100%	100%	100%

Our Automotive Services business, which will do business as ADESA after the spin-off, operates two main businesses that are integral parts of the vehicle redistribution industry in North America. Wholesale vehicle auctions include 53 used vehicle auctions, 27 salvage vehicle auctions and related services, while dealer financing consists of AFC's 80 loan production offices. Our Automotive Services business will remain based in Indiana.

After the spin-off, ALLETE will be comprised of our Energy Services business, which includes Minnesota Power, SWL&P, BNI Coal, Enventis Telecom and Rainy River Energy, ALLETE Properties, Inc., our real estate operations in Florida, and our emerging technology investments. ALLETE's headquarters will remain in Duluth, Minnesota.

Our Board of Directors has retained financial and legal advisors to work with management on the refinancing of ALLETE's and Automotive Services' debt which will precede the spin-off. The spin-off is subject to the approval of the final plan by ALLETE's Board of Directors, favorable market conditions, receipt of tax opinions, satisfaction of SEC requirements and other customary conditions, and is expected to occur in the third quarter of 2004.

Sale of Water Plant Assets. During 2003 we substantially completed the sale of our Water Services businesses. Approximately 90% of our water assets in Florida were sold, under condemnation or imminent threat of condemnation, during 2003 for a total sales price of approximately $445 million. Proceeds were used to pay down debt which strengthened our balance sheet. In addition, we reached an agreement to sell our North Carolina water assets for

$48 million and the assumption of approximately $28 million in debt by the purchaser. The North Carolina sale is awaiting approval of the NCUC and is expected to close in mid-2004. We expect to enter into agreements to sell our remaining water assets in Florida and Georgia in 2004.

In October 2003 the FPSC voted to initiate a proceeding to examine whether the sale of Florida Water's assets involves a gain that should be shared with Florida Water's customers. The question raised is whether the entire gain from the asset sales should go to Florida Water and its shareholders, or should it be shared with customers. In November 2003 the FPSC issued a final order regarding a similar gain on sale issue for Utilities, Inc. of Florida. In that order the FPSC made several findings that could be helpful to Florida Water's case, namely that courts have found that rates paid by customers do not vest ratepayers with ownership rights to the property used to render service, and shareholders bear the risk of gain or loss associated with investments made to provide service. Florida Water intends to vigorously contest any decision to seek sharing of the gain with customers. Florida Water is unable to predict the outcome of this proceeding.

Energy Services

We categorize our Energy Services businesses as regulated utility operations or nonregulated operations. Regulated utility operations include rate regulated activities associated with generation, transmission and distribution of electricity under the jurisdiction of state and federal regulatory authorities. Nonregulated operations consist of coal mining, nonregulated generation (non-rate base generation sold at market-based rates to the wholesale market) and telecommunications. The discussion below summarizes the major businesses we include in Energy Services. Statistical information is presented as of December 31, 2003 unless otherwise indicated. All subsidiaries are wholly owned unless otherwise specifically indicated.

Minnesota Power, an operating division of ALLETE, Inc., provides regulated utility electric service in a 26,000 square mile service territory in northeastern Minnesota. Minnesota Power supplies regulated utility electric service to 135,000 retail customers and wholesale electric service to 16 municipalities. In addition, Minnesota Power has nonregulated generation operations at the Taconite Harbor facility in northern Minnesota. **SWL&P** provides regulated utility electric, natural gas and water service in northwestern Wisconsin. SWL&P has 14,000 electric customers, 12,000 natural gas customers and 10,000 water customers.

Minnesota Power had an annual net peak load of 1,463 MW on January 13, 2003. Our power supply sources are listed on the following page.

We have electric transmission and distribution lines of 500 kV (8 miles), 230 kV (606 miles), 161 kV (43 miles), 138 kV (66 miles), 115 kV (1,259 miles) and less than 115 kV (6,935 miles). We own and operate 179 substations with a total capacity of 8,562 megavoltamperes. Some of our transmission and distribution lines interconnect with other utilities.

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

As of February 2004 Minnesota Power withdrew from active participation in Split Rock Energy, a joint venture with Great River Energy, and will terminate its ownership interest upon receipt of FERC approval which is expected in the first half of 2004. (See Nonregulated Generation and Power Marketing.)

BNI Coal owns and operates a lignite mine in North Dakota. BNI Coal is the lowest-cost supplier of lignite in North Dakota producing about 4 million tons annually. Two electric generating cooperatives, Minnkota Power and Square Butte, presently consume virtually all of BNI Coal's production of lignite under cost-plus fixed fee coal supply agreements expiring in 2027. (See Fuel and Note 15.)

Enventis Telecom is an integrated data services provider offering fiber optic-based communication and advanced data services to businesses and communities in the Upper Midwest. Enventis Telecom provides converged IP (or Internet protocol) services that allow all communications (voice, video and data) to use the same optic-based delivery technology. Enventis Telecom owns or has rights to approximately 1,600 route miles of fiber optic cable. These route miles contain multiple fibers that total approximately 47,000 fiber miles. Enventis Telecom also owns optronic and data switching equipment that is used to "light up" the fiber optic cable. Enventis Telecom services customers from facilities that are primarily leased from third parties.

Rainy River Energy is engaged in the acquisition and development of nonregulated generation and wholesale power marketing. Rainy River Energy has entered into a 15-year power purchase agreement with NRG Energy at a facility in Kendall County, Illinois. (See Nonregulated Generation and Power Marketing - Kendall County.)

Regulated Utility Electric Sales

Our regulated utility operations include retail and wholesale activities under the jurisdiction of state and federal regulatory authorities. (See Regulatory Issues.)

PART I

Power Supply

Regulated Utility	Unit No.	Year Installed	Net Winter Capability	For the Year Ended December 31, 2003 Electric Requirements	
			MW	MWh	%
Steam					
Coal-Fired					
Boswell Energy Center	1	1958	69		
near Grand Rapids, MN	2	1960	69		
	3	1973	349		
	4	1980	427		
			914	6,445,652	55.0%
Laskin Energy Center	1	1953	55		
in Hoyt Lakes, MN	2	1953	55		
			110	643,340	5.5
Purchased Steam					
M.L. Hibbard Station in Duluth, MN	3 & 4	1949, 1951	48	–	–
Total Steam			1,072	7,088,992	60.5
Hydro					
Group consisting of ten stations in MN		Various	115	409,521	3.5
Purchased Power					
Square Butte burns lignite coal near Center, ND			322	2,288,921	19.5
All Other — Net			–	1,938,958	16.5
Total Purchased Power			322	4,227,879	36.0
Total			1,509	11,726,392	100.0%

Nonregulated	Unit No.	Year Installed	Year Acquired	Net Capability
				MW
Steam				
Coal-Fired				
Taconite Harbor Energy Center in Taconite Harbor, MN	1, 2 & 3	1957, 1957, 1967	2001	200
Cloquet Energy Center in Cloquet, MN	5	2001	2001	23
Rapids Energy Center (a) in Grand Rapids, MN	6 & 7	1980	2000	29
Hydro				
Conventional Run-of-River				
Rapids Energy Center (a) in Grand Rapids, MN	4 & 5	1917	2000	1
Power Purchase Agreement				
Kendall County (Rainy River Energy) located southwest of Chicago, IL	3	2002	2002	275

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

Regulated Utility Electric Sales

For the Year Ended December 31	2003	2002	2001
Millions of Killowatthours			
Retail			
Residential	1,066	1,044	998
Commercial	1,286	1,257	1,234
Industrial	6,558	6,946	6,549
Other	79	78	75
Wholesale			
Municipals and Others	2,155	1,807	2,086
	11,144	11,132	10,942

Minnesota Power has wholesale contracts with 16 municipal customers. (See Regulatory Issues - Federal Energy Regulatory Commission.)

Approximately 60% of the ore consumed by integrated steel facilities in the United States originates from six taconite customers of Minnesota Power. Taconite, an iron-bearing rock of relatively low iron content that is abundantly available in Minnesota, is an important domestic source of raw material for the steel industry. Taconite processing plants use large quantities of electric power to grind the ore-bearing rock, and agglomerate and pelletize the iron particles into taconite pellets. Annual taconite production in Minnesota was 34 million tons in 2003 (39 million tons in 2002; 33 million tons in 2001). The decrease in 2003 taconite production was due to the May 2003 shutdown of the Eveleth Mines LLC operations that then reopened in December 2003 as United Taconite LLC under new ownership that includes Cleveland-Cliffs Inc. and Laiwu Steel Group, a Chinese-based steel producer. A rise in Chinese steel demand and production has created a new market for the producers of taconite in North America. United Taconite has the ability to produce 5 million to 6 million tons of taconite annually with a portion of that production replacing taconite pellets that will be shipped to China from other Cleveland-Cliffs Inc. owned taconite operations. The decrease in 2001 taconite production was due to the closing of LTV and the reduced demand for iron ore from the operating mines as a result of high steel import levels and a softer economy. LTV, which was not a Large Power Customer (defined below), formerly produced 7 million to 8 million tons of taconite annually. Based on our research of the taconite industry, Minnesota taconite production for 2004 is anticipated to be about 39 million tons. As a result of continuing consolidation in the integrated steel business and its resulting impact on taconite producers, Minnesota Power is unable to predict taconite production levels for the next two to five years. We expect any excess energy not used by our retail customers will be marketed primarily to the regional wholesale market.

Large Power Customer Contracts. Minnesota Power has large power customer contracts with 12 customers (Large Power Customers), each of which requires 10 MW or more of generating capacity. Large Power Customer contracts require Minnesota Power to have a certain amount of generating capacity available. (See Minimum Revenue and Demand Under Contract Table.) 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 biannual (power pool season) basis and require that a portion of their megawatt needs be committed on a take-or-pay basis for at least a portion of the agreement. In addition to the demand charge, each Large Power Customer is billed an energy charge for each kilowatthour used that recovers the variable costs incurred in generating electricity. Six of the Large Power Customers have interruptible service for a portion of their needs which provides a discounted demand rate and energy priced at Minnesota Power's incremental cost after serving all firm power obligations. Minnesota Power also provides incremental production service for customer demand levels above the contract take-or-pay levels. There is no demand charge for this service and energy is priced at an increment above Minnesota Power's cost. Incremental production service is interruptible. Contracts with 8 of the 12 Large Power Customers provide for deferral without interest of one-half of demand charge obligations incurred during the first three months of a strike or illegal walkout at a customer's facilities, with repayment required over the 12-month period following resolution of the work stoppage.

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

Minimum Revenue and Demand Under Contract as of March 1, 2004

	Minimum Annual Revenue (a)	Monthly Megawatts
2004	$99.5 million	635
2005	$50.5 million	294
2006	$36.1 million	202
2007	$30.6 million	181
2008	$16.2 million	93

(a) Based on past experience, we believe revenue from Large Power Customers will be substantially in excess of the minimum contract amounts.

Contract Status for Minnesota Power Large Power Customers as of March 1, 2004

Customer	Industry	Location	Ownership	Earliest Termination Date
Hibbing Taconite Co.	Taconite	Hibbing, MN	62.3% International Steel Group, Inc. 23% Cleveland-Cliffs Inc. 14.7% Stelco Inc.	December 31, 2008
Ispat Inland Mining Company (a)	Taconite	Virginia, MN	Ispat Inland Steel Company	March 31, 2008
U.S. Steel Corp. (USS) Minntac (a)	Taconite	Mt. Iron, MN	U.S. Steel Corp.	March 31, 2008
USS Keewatin Taconite (a,b)	Taconite	Keewatin, MN	U.S. Steel Corp.	March 31, 2008
United Taconite LLC (c)	Taconite	Eveleth, MN	70% Cleveland-Cliffs Inc. 30% Laiwu Steel Group	October 31, 2008
Blandin Paper Company	Paper	Grand Rapids, MN	UPM-Kymmene Corporation	April 30, 2007
Boise Paper Solutions	Paper	International Falls, MN	Boise Cascade Corporation	December 31, 2008
Sappi Cloquet LLC	Paper	Cloquet, MN	Sappi Limited	December 31, 2008
Stora Enso North America, Duluth Paper Mill and Duluth Recycled Pulp Mill	Paper and Pulp	Duluth, MN	Stora Enso Oyj	April 30, 2009
USG Interiors, Inc.	Manufacturer	Cloquet, MN	USG Corporation	December 31, 2005
Enbridge Energy Company, Limited Partnership (d)	Pipeline	Deer River, MN Floodwood, MN	Enbridge Energy Company, Limited Partnership	March 31, 2005
Minnesota Pipeline Company (d)	Pipeline	Staples, MN Little Falls, MN Park Rapids, MN	60% Koch Pipeline Co. L.P. 40% Marathon Ashland Petroleum LLC	March 31, 2005

(a) The contract will terminate four years from the date of written notice from either Minnesota Power or the customer. No notice of contract cancellation has been given by either party. Thus, the earliest date of cancellation is March 31, 2008.
(b) Formerly National Steel Pellet Co., now renamed USS Keewatin Taconite. USS assumed the National Steel Pellet Co. Large Power Customer contract.
(c) In late 2003 United Taconite LLC was the successful bidder in a bankruptcy auction sale of the assets of Eveleth Mines LLC, previously a Large Power Customer of Minnesota Power. United Taconite assumed the Eveleth Mines Large Power Customer contract.
(d) The contract will terminate one year from the date of written notice from either Minnesota Power or the customer. No notice of contract cancellation has been given by either party. Thus, the earliest date of cancellation is March 31, 2005.

Regulated Utility Purchased Power

Minnesota Power has contracts to purchase capacity and energy from various entities. The largest contract is with Square Butte. Under an agreement with Square Butte expiring at the end of 2026, Minnesota Power is currently entitled to approximately 71% (66% beginning in 2006) of the output of a 455-MW coal-fired generating unit located near Center, North Dakota. (See Note 15.)

Fuel

Minnesota Power purchases low-sulfur, sub-bituminous coal from the Powder River Basin coal field located in Montana. Coal consumption in 2003 for electric generation at Minnesota Power's Minnesota coal-fired generating stations was about 5.6 million tons. As of December 31, 2003 Minnesota Power had a coal inventory of about 632,000 tons. Minnesota Power has three coal supply agreements with various expiration dates extending through 2009. Under these agreements Minnesota Power has the tonnage flexibility to procure 70% to 100% of its total coal requirements. In 2004 Minnesota Power will obtain coal under these coal supply agreements and in the spot market. This diversity in coal supply options allows Minnesota Power to manage market price and supply risk and to take advantage of favorable spot market prices. Minnesota Power is exploring future coal supply options. It believes that adequate supplies of low-sulfur, sub-bituminous coal will continue to be available.

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

Coal Delivered to Minnesota Power

Year Ended December 31	2003	2002	2001
Average Price Per Ton	$20.02	$21.48	$20.52
Average Price Per MBtu	$1.12	$1.19	$1.18

The Square Butte generating unit operated by Minnkota Power burns North Dakota lignite coal supplied by BNI Coal, in accordance with the terms of a contract expiring in 2027. Square Butte's cost of lignite burned in 2003 was approximately 66 cents per MBtu. The lignite acreage that has been dedicated to Square Butte by BNI Coal is located on lands essentially all of which are under private control and presently leased by BNI Coal. This lignite supply is sufficient to provide the fuel for the anticipated useful life of the generating unit.

Nonregulated Generation and Power Marketing

Nonregulated generation is non-rate base generation sold at market-based rates to the wholesale market.

Taconite Harbor. In 2002 we started the Taconite Harbor generating facilities which we purchased in 2001. The generation output is primarily being sold in the wholesale market and is allocated in limited circumstances to Minnesota Power's utility customers.

Kendall County. In September 1999 Rainy River Energy entered into an amended 15-year power purchase agreement (Kendall County) with a company that was subsequently purchased by NRG Energy, an independent power producer. The Kendall County agreement includes the purchase of the output of one entire unit (approximately 275 MW) of a four unit (approximately 1,100 MW) natural gas-fired combined cycle generation facility located near Chicago, Illinois. Construction of the generation facility was completed in 2002. Rainy River Energy's obligation to pay fixed capacity related charges began May 1, 2002 and will end on September 16, 2017. We currently have 130 MW (100 MW in 2003) of long-term capacity sales contracts for the Kendall County generation, with 50 MW expiring in April 2012 and 80 MW in September 2017.

Split Rock Energy is a joint venture of Minnesota Power and Great River Energy from which Minnesota Power is withdrawing. Great River Energy is a consumer-owned generation and transmission cooperative and is Minnesota's second largest utility in terms of generating capacity. The joint venture combined the two companies' power supply capabilities and customer loads for power pool operations and generation outage protection. As of February 2004 in response to the changing strategies of both parties, Minnesota Power withdrew from active participation in Split Rock Energy, and will terminate its ownership interest upon receipt of FERC approval which is expected in the first half of 2004. Some of the benefits of this partnership have been retained, such as joint load and capability reporting with Great River Energy. Minnesota Power has resumed functions that provide least cost supply to our retail customers and marketing power in our region based on supplies available from our generating assets.

Other. Rainy River Energy Corporation – Wisconsin continues to study the feasibility of the construction of a natural gas-fired electric generating facility in Superior, Wisconsin. In accordance with the PSCW's final order approving the project, Rainy River Energy undertook preliminary site preparation work in November and December of 2003.

In 2003 we sold 1.5 million MWh of nonregulated generation (1.2 million in 2002 and 0.2 million in 2001).

Regulatory Issues

We are exempt from regulation under the Public Utility Holding Company Act of 1935 (PUHCA), except as to Section 9(a)(2) which relates to acquisition of securities of public utility companies. If passed in its current form, the pending federal energy bill will repeal PUHCA. However, we cannot predict the future of this legislative effort.

We are subject to the jurisdiction of various regulatory authorities. The MPUC has regulatory authority over Minnesota Power's service area in Minnesota, retail rates, retail services, issuance of securities and other matters. The FERC has jurisdiction over the licensing of hydroelectric projects, the establishment of rates and charges for the sale of electricity for resale and transmission of electricity in interstate commerce, and certain accounting and record keeping practices. The PSCW has regulatory authority over the retail sales of electricity, water and gas by SWL&P. The MPUC, FERC and PSCW had regulatory authority over 23%, 3% and 3%, respectively, of our 2003 consolidated operating revenue.

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

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

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

Federal Energy Regulatory Commission. The FERC has jurisdiction over our wholesale electric service and operations. Minnesota Power's hydroelectric facilities, which are located in Minnesota, are licensed by the FERC. (See Environmental Matters - Water.)

Minnesota Power has contracts with 16 Minnesota municipalities receiving wholesale electric service. Two contracts are for service through 2005, while the other 14 are for service through at least 2007. In 2003 municipal customers purchased 735,000 MWh from Minnesota Power.

Minnesota Power and SWL&P are members of the MISO. Minnesota Power and SWL&P retain ownership of their respective transmission assets and control area functions, but their transmission network is under the regional operational control of the MISO. They take and provide transmission service under the MISO open access transmission tariff. In December 2001 FERC approved the MISO as the nation's first regional transmission organization (RTO) under FERC's Order No. 2000 criteria, noting that it believes the MISO will benefit the public interest by enhancing the reliability of the Midwest electric grid and facilitating and enhancing wholesale competition. The MISO plans to accomplish this primarily through standardization of rates, terms and conditions of transmission service over a broad region encompassing all or parts of 20 states and one Canadian province, and over 120,000 MW of generating capacity. MISO operations were phased in during the first half of 2002. In late 2003 the MISO and the PJM Interconnection LLC, an RTO serving all or parts of Pennsylvania, New Jersey, the District of Columbia, Maryland, Ohio, Virginia, West Virginia and Delaware, executed a joint operating agreement. The joint operating agreement, filed with the FERC, will provide detailed information about each others' operations and establishes procedures to strengthen and coordinate reliability.

The FERC is currently developing rules for a standard market design intended to further define the functions and transmission tariff of the MISO and other regional transmission providers. The MISO is focusing on reliability procedures and on implementation of the FERC's standard market design elements by development of an energy market tariff or tariffs if MISO membership determines to form subregional markets within MISO. The MISO expects that an energy market tariff will be filed with the FERC in the first half of 2004. Minnesota Power will review the effects of the proposed definitive energy tariff at that time.

Minnesota Power also participates in MAPP, a power pool operating in parts of eight states in the Upper Midwest and in three provinces in Canada. MAPP functions include a regional reliability council that maintains generation reserve sharing requirements. Minnesota Power is a member of the Mid-Continent Area Energy Marketers Association (MEMA), recently formed to provide a regional tariff for wholesale power and energy marketing under which its members trade. On December 2, 2003 MEMA's wholesale capacity and energy tariff was approved by the FERC and became effective.

Minnesota Public Utilities Commission. Minnesota Power's retail rates are based on a 1994 MPUC retail rate order that allows for an 11.6% return on common equity dedicated to utility plant and resulted in an average rate increase of approximately 6%. Minnesota Power is in the early stages of preparing a request to increase rates for its utility operations sometime in the first half of 2005. The request may be necessary to cover changes in the increased cost of doing business.

At the end of 2003 our equity ratio was 64.44%, which was greater than the 55.03% plus or minus 15% (46.78% to 63.29%) approved by the MPUC in its 2003 order authorizing our capital structure. Our equity ratio was higher than the approved MPUC ratio due to the recognition of gains from the sale of our Water Services businesses and the redemption of long-term debt. On January 23, 2004 we filed an amendment with the MPUC requesting that effective no later than March 1, 2004 a new equity ratio of 61.53% plus or minus 15% (52.30% to 70.76%) be established until such time as our 2004 capital structure is approved. On February 18, 2004 the MPUC approved Minnesota Power's request.

In June 2003 the MPUC initiated an investigation into the continuing usefulness of the fuel clause as a regulatory tool for electric utilities. Minnesota Power's initial comments on the proposed scope and procedure of the investigation were filed in July 2003. In November 2003 the MPUC approved the initial scope and procedure of the investigation. The investigation will focus on whether the fuel clause continues to be an appropriate regulatory tool. The initial steps will be to review the clause's original purpose, structure and rationale of the fuel adjustment clause (including its current operation and relevance in today's regulatory environment), and then address its ongoing appropriateness and other issues if the need for continued use of the fuel adjustment clause is shown. Because this investigation is in its early stages, we are unable to predict the outcome or impact, if any, at this time.

Minnesota requires investor owned electric utilities to spend a minimum of 1.5% of gross annual retail electric revenue on CIP each year. These investments are recovered from retail customers through a billing adjustment and amounts included in retail base rates. The MPUC allows utilities to accumulate, in a deferred account for future recovery, all CIP expenditures as well as a carrying charge on the deferred account balance. Minnesota Power's CIP investment goal was $2.9 million for 2003 ($2.9 million for 2002; $2.7 million for 2001) with actual spending of $5.2 million in 2003 ($4.0 million in 2002; $2.6 million in 2001). These amounts satisfied current spending requirements and all prior years' spending shortfalls.

Public Service Commission of Wisconsin. SWL&P's current electric retail rates are based on a September 2001 PSCW retail rate order that allows for a 12.25% return on common equity and resulted in an average rate decrease of 3.4%. SWL&P is preparing to file with the PSCW in mid-2004 a request to increase retail rates for its utility operations to be effective sometime in early 2005. The request would cover changes in the cost of doing business.

The ownership, control and operation of any affiliated wholesale nonregulated generating plants in Wisconsin is subject to PSCW approval.

In December 2003 the PSCW unanimously approved the revised $420 million cost estimate for the Wausau-to-Duluth electric transmission line that Minnesota Power, the American Transmission Company (ATC) and Wisconsin Public Service Corporation have proposed. The line had been projected to cost about $215 million. The increased costs for the 220-mile, 345-kV line are attributable to higher prices for construction materials, increased payments to landowners, more aggressive environmental safeguards and a different accounting calculation for interest on funds used during construction for ATC. Despite the cost increase, Minnesota Power and transmission planners throughout the region believe the transmission line is necessary. Minnesota Power is actively involved in the permitting and construction activities which began at the end of January 2004; however, it does not intend to finance or own the proposed line. An application to cross the Namekagon River in Wisconsin was filed with the National Park Service (NPS) in November 2001, and a draft Environmental Impact Statement is expected to be issued by the NPS in early 2004. Construction is currently anticipated to be complete in 2008.

Competition

Industry Restructuring. State efforts across the country to restructure the electric utility industry have slowed. Legislation or regulation that would allow retail customer choice of their electric service provider has not gained momentum in either Minnesota or Wisconsin.

At the national level the FERC continues in its efforts to have companies join RTOs. FERC's sweeping Standard Market Design rulemaking, renamed the Wholesale Market Platform, appears to have stalled, although FERC remains committed to implementing most of the rule in a more piecemeal fashion. Minnesota Power supports the creation of a robust wholesale electric market.

The electricity title of the pending federal energy legislation seeks to maintain reliability, increase investments in new transmission capacity and energy supply, and address wholesale price volatility while encouraging wholesale competition. This legislation remains the subject of significant controversy. We cannot predict the timing or substance of any future legislation or regulation.

Franchises

Minnesota Power holds franchises to construct and maintain an electric distribution and transmission system in 90 cities and towns located within its electric service territory. SWL&P holds similar franchises for electric, natural gas and/or water systems in 15 cities and towns within its service territory. The remaining cities and towns served do not require a franchise to operate within their boundaries. Our exclusive service territories are established by state regulatory agencies.

Employees

At December 31, 2003 Energy Services had 1,400 full-time employees.

Minnesota Power, SWL&P and Enventis Telecom have 596 employees who are members of the International Brotherhood of Electrical Workers (IBEW), Local 31. A labor agreement between Minnesota Power and Local 31, which includes Enventis Telecom, was in effect through January 31, 2004. On February 25, 2004 IBEW Local 31 approved a new two-year labor agreement with Minnesota Power, SWL&P and Enventis Telecom that will be in effect through January 31, 2006. The agreement provides wage increases of 3.25% in each of the two contract years. The union voted to discontinue their participation in the Results Sharing program as of the end of 2003.

BNI Coal had 96 employees who were members of the IBEW Local 1593. BNI Coal and Local 1593 have a labor agreement which expires on March 31, 2004. In accordance with terms of that agreement, a 3% increase took effect July 1, 2003. Negotiations are underway for a new contract that would begin after the March 31, 2004 expiration date.

Environmental Matters

Certain businesses included in our Energy Services segment are subject to regulation by various federal, state and local authorities of air quality, water quality, solid wastes and other environmental matters. We consider these businesses to be in substantial compliance with those environmental regulations currently applicable to their operations and believe all necessary permits to conduct such operations have been obtained. We 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. These accruals are adjusted periodically as assessment and remediation efforts progress, or as additional technical or legal information become available. Accruals for environmental liabilities are included in the balance sheet at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. Costs related to environmental contamination treatment and cleanups are charged to expense.

Air. Minnesota Power's regulated generating facilities in Minnesota mainly burn low-sulfur western sub-bituminous coal and Square Butte, located in North Dakota, burns lignite coal. All of these facilities are equipped with pollution control equipment such as scrubbers, baghouses or electrostatic precipitators. The federal Clean Air Act Amendments of 1990 (Clean Air Act) created emission allowances for sulfur dioxide. Each allowance is an authorization to emit one ton of sulfur dioxide, and each utility must have sufficient allowances to cover its annual emissions. Sulfur dioxide emission requirements are currently being met by all of Minnesota Power's generating facilities. Most Minnesota Power facilities have surplus allowances. Taconite Harbor expects to meet its sulfur dioxide requirements by annually purchasing allowances, since it receives no allowance allocation. Square Butte anticipates meeting its sulfur dioxide requirements

through increased use of existing scrubbers and by annually purchasing additional allowances as necessary.

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

Minnesota Power has obtained all necessary Title V air operating permits from the MPCA for its applicable facilities to conduct electric operations.

In December 2000 the EPA announced its decision to regulate mercury emissions from coal and oil-fired power plants under Section 112 of the Clean Air Act. Section 112 will require all such power plants in the United States to adhere to the EPA maximum achievable control technology (MACT) standards for mercury. The EPA issued a proposed rule in December 2003. Final regulations defining control requirements are planned for December 2004. The proposed rule offers two different types of regulation: imposition of an annual average mercury emission limitation applied at each unit or facility average under Section 112 and imposition of a cap and trade program under Section 111, where an allocation of mercury credits would be assigned and utilities would need to provide for a combination of emission reductions and credit purchases to demonstrate compliance. The EPA is soliciting comments about these approaches. In either approach, continuous monitoring of mercury stack emissions is required to be in service around 2008. Minnesota Power's preliminary estimates suggest that all of our affected facilities can be outfitted with continuous mercury emission monitors for under $2 million. Our unit mercury emissions tests indicate all of our units should comply with the proposed unit specific target emission rate without significant additional cost. Cost estimates about mercury cap and trade program impacts would be premature at this time. The EPA is still soliciting comments about this proposed alternative program and associated final mercury credit allocations to units have not yet been defined.

During 2002 Minnesota Power received and responded to a third request from the EPA, under Section 114 of the Clean Air Act, seeking additional information regarding capital expenditures at all of its coal-fired generating stations. This action is part of an industry-wide investigation assessing compliance with the New Source Review and the New Source Performance Standards (emissions standards that apply to new and changed units) of the Clean Air Act at electric generating stations. We have received no feedback from the EPA based on the information we submitted. There is, however, ongoing litigation involving the EPA and other electric utilities for alleged violations of these rules. It is expected that the outcome of some of the cases could provide the utility industry direction on this topic. We are unable to predict what actions, if any, may be required as a result of the EPA's request for information. As a result, we have not accrued any liability for this environmental matter.

In December 2002 the EPA issued changes to the existing New Source Review rules. These rules changed the procedures for MPCA review of projects at our electric generating facilities. In October 2003 the EPA announced changes clarifying the application of certain sections of the New Source Review rules. These changes are not expected to have a material impact on Minnesota Power. On December 24, 2003 the U.S. Court of Appeals for the District of Columbia Circuit stayed the implementation of the October 2003 rule pending their further review which is expected sometime in 2004.

In June 2002 Minnkota Power, the operator of Square Butte, received a Notice of Violation from the EPA regarding alleged New Source Review violations at the M.R. Young Station which includes the Square Butte generating unit. The EPA claims certain capital projects completed by Minnkota Power should have been reviewed pursuant to the New Source Review regulations potentially resulting in new air permit operating conditions. Minnkota Power has held several meetings with the EPA to discuss the alleged violations. Based on an EPA request, Minnkota Power performed a study related to the technological feasibility of installing various controls for the reduction of nitrogen oxides and sulfur dioxide emissions. Discussions with the EPA are ongoing and we are still unable to predict the outcome or cost impacts. If Square Butte is required to make significant capital expenditures to comply with EPA requirements, we expect such capital expenditures to be debt financed. Our future cost of purchased power would include our pro rata share of this additional debt service. (See Note 15.)

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

Minnesota Power holds FERC licenses authorizing the ownership and operation of seven hydroelectric generating projects with a total generating capacity of about 115 MW. In June 1996 Minnesota Power filed in the U.S. Court of Appeals for the District of Columbia Circuit a petition for review of the license as issued by the FERC for Minnesota Power's St. Louis River Hydro Project. Separate petitions for review were also filed by the U.S. Department of the Interior and the Fond du Lac Band of Lake Superior Chippewa (Fond du Lac Band), two intervenors in the licensing proceedings. The court consolidated the three petitions for

review and suspended the briefing schedule while Minnesota Power and the Fond du Lac Band negotiate a reasonable fee for the use of tribal lands as mandated by the new license. Both parties informed the court that these negotiations may resolve other disputed issues, and they are obligated to report periodically to the court the status of these discussions. Beginning in 1996, and most recently in February 2004, Minnesota Power filed requests with the FERC for extensions of time to comply with certain plans and studies required by the license that might conflict with the settlement discussions. The Fond du Lac Band, the U.S. Department of the Interior and Minnesota Power have reached a settlement agreement for the St. Louis River Hydro Project. This settlement must be approved by the FERC who would then amend the project license to reflect the conditions of the settlement agreement. Minnesota Power is in the process of preparing the filing for submission to the FERC in mid 2004.

Solid and Hazardous Waste. The Resource Conservation and Recovery Act of 1976 regulates the management and disposal of solid wastes and hazardous wastes. As a result of this legislation, the EPA has promulgated various hazardous waste rules. Minnesota Power is required to notify the EPA of hazardous waste activity and routinely submits the necessary annual reports to the EPA. The MPCA and the Wisconsin Department of Natural Resources (WDNR) are responsible for administering solid and hazardous waste rules on the state level with oversight by the EPA.

In response to EPA Region V's request for utilities to participate in the Great Lakes Initiative by voluntarily removing remaining polychlorinated biphenyl (PCB) inventories, Minnesota Power has scheduled replacement of PCB capacitor banks and PCB-contaminated oil by the end of 2004. The total cost is expected to be about $2.0 million of which $1.5 million was spent through December 31, 2003.

In May 2001 SWL&P received notice from the WDNR that the City of Superior had found soil contamination on property adjoining a former Manufactured Gas Plant (MGP) site owned and operated by SWL&P's predecessors from 1889 to 1904. The WDNR requested SWL&P to initiate an environmental investigation. The WDNR also issued SWL&P a Responsible Party letter in February 2002. The environmental investigation is underway. In February 2003 SWL&P submitted a Phase II environmental site investigation report to the WDNR. This report identified some MGP-like chemicals that were found in the soil. During March and April 2003 sediment samples were taken from nearby Superior Bay. The report on the results of this sampling is expected to be completed and sent to the WDNR during the first quarter of 2004. A work plan for additional investigation by SWL&P was filed on December 17, 2003 with the WDNR. This part of the investigation will determine any impact to soil or ground water between the former MGP site and the Superior Bay. Although it is not possible to quantify the potential clean-up cost until the investigation is completed and a work plan is developed, a $0.5 million liability was recorded as of December 31, 2003 to address the known areas of contamination. We have recorded a corresponding dollar amount as a regulatory asset to offset this liability. The PSCW has approved SWL&P's deferral of these MGP environmental investigation and potential clean-up costs for future recovery in rates, subject to regulatory prudency review.

Automotive Services

Automotive Services, headquartered in Carmel, Indiana, operates two main businesses that are integral parts of the vehicle redistribution industry in the United States and Canada: auctions and related services, and dealer financing. Automotive Services includes several wholly owned subsidiaries, including ADESA, ADESA Impact and AFC. The proposed spin-off is expected to take the form of a tax-free stock dividend to ALLETE's shareholders, who would receive one ADESA, Inc. share for each share of ALLETE common stock. ADESA, Inc. will be the parent company of the subsidiaries we include in Automotive Services. Automotive Services plans to grow by growing auction sales volume, optimizing revenue per vehicle sold, continuing to improve operating efficiency, expanding into new markets, and growing on-line auctions and related services. The discussion below summarizes the businesses we include in Automotive Services. Statistical information is presented as of December 31, 2003 unless otherwise indicated.

Wholesale Vehicle Auctions

We are the leading, national provider of wholesale vehicle auctions and related vehicle redistribution services for the automotive industry in North America. Most of our locations are stand-alone facilities dedicated to either used vehicle auctions or salvage auctions, but in several locations, we have been able to capitalize on the synergies of utilizing our facilities for both types of auctions. In addition to vehicle auction services, we also provide auctions and related services for specialty vehicles and equipment unique to the recreational vehicle, commercial trucking, construction and utility industries.

We provide Internet-based solutions to institutional sellers who wish to redistribute their vehicles to either franchised and/or independent dealers, including on-line and bulletin board on-line live auctions running simultaneously with our physical auctions. We feel that the physical auctions we operate offer a superior method of vehicle redistribution when compared to on-line auctions. As the use of on-line auctions has become an accepted practice in the vehicle redistribution industry, we have developed on-line auction technologies to complement our physical auction business. We believe we are well positioned to offer the appropriate mix of physical and on-line auctions and services to our customers to ensure the most effective and efficient redistribution of their vehicles.

Used Vehicle Auctions and Related Services. We are the second largest wholesale used vehicle auction network in the United States and the largest in Canada. We operate 53 used vehicle auction facilities in close proximity to large concentrations of used vehicle dealers throughout North America, which we own or lease. Each auction is a multi-lane, drive-through facility, and may have additional buildings for reconditioning, registration, maintenance, bodywork, and other ancillary and administrative services. Each auction also has secure parking areas to store vehicles for auction. (See Used Vehicle Auctions Table.) Our customers sold 1,810,000 used vehicles at our auctions in 2003 (1,741,000 in 2002; 1,761,000 in 2001).

Auctions are the hub of a massive redistribution system for used vehicles. Our auctions enable institutional customers and selling dealers to sell used vehicles to licensed franchised, independent and wholesale used vehicle dealers. Our mission is to maximize the auction sales price for the sellers of used vehicles by effectively and efficiently transferring the vehicles, paperwork (including certificates of title and other evidence of ownership), and funds as quickly as possible from the sellers to a large population of dealers seeking to fill their inventory for resale to retail consumers. Auctions are held at least weekly at every location and provide real-time wholesale market prices for the vehicle redistribution industry. During the sales process, we do not generally take title to or ownership of the vehicles consigned for auction but instead facilitate the transfer of vehicle ownership directly from seller to buyer.

A central measure to the results of the used vehicle auction process is the conversion percentage, which represents the number of vehicles sold as a percent of the vehicles offered for sale. The number of vehicles offered for sale is the key driver of the costs incurred in, and the number of vehicles sold is the key driver of the related fees generated by, the redistribution process. Generally, as the conversion percentage increases, so do the profitability and efficiency of our auctions.

We provide a full range of services to both buyers and sellers, including:

- Auction services, such as marketing and advertising the vehicles to be auctioned, dealer registration, storage of consigned and purchased inventory, clearing of funds, arbitration of disputes, auction vehicle registration, condition report processing, security for consigned inventory, sales results reports, pre-sale lineups, and actual auctioning of vehicles by licensed auctioneers.
- Internet-based solutions, including on-line bulletin board auctions and on-line live auctions running simultaneously with our physical auctions.
- Inbound and outbound logistics administration with services provided by both third party carriers and our auctions.
- Reconditioning services, including detailing, washing, body work, light mechanical work, glass repair, dent repair, tire and key replacement, and upholstery repair.
- Inspection and certification services whereby the auction performs a physical inspection and produces a condition report, in addition to varying levels of diagnostic testing for purposes of certification.
- Title processing and other paperwork administration.
- Outsourcing of remarketing functions and end of lease term management.

Each of these services may also be purchased separately from the auction process.

Salvage Auctions and Related Services. We are currently the third largest salvage auction operator in North America, where the top three operators constitute an estimated 72% of the vehicles sold through auctions. We operate 27 salvage auction facilities in the United States and Canada. Salvage auctions are generally smaller than used vehicle auctions in terms of acreage and building size and some locations share facilities with our used vehicle auctions. Most salvage vehicles cannot be driven through lanes, and salvage auction facilities are therefore less complex than wholesale used vehicle auction facilities, consisting primarily of large lots for depositing salvage vehicles. Salvage auction facilities typically have a small office building and a garage for truck and loader repairs. (See Salvage Vehicle Auctions Table.) Our customers, primarily insurance companies, sold an estimated 191,000 salvage vehicles at our auctions in 2003 (175,000 in 2002; 148,000 in 2001).

Salvage vehicles are damaged vehicles that are branded as total losses for insurance or business purposes as well as recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made. We offer a comprehensive selection of salvage recovery services in addition to the core auction process including inbound and outbound logistics, remarketing vehicle claims services such as vehicle inspection, evaluation, titling and settlement administration, remarketing and theft-recovered vehicle services. Used together or independently, these services provide efficiency and speed of service to our customers, helping them to mitigate their losses and manage the costs related to processing the claims and related vehicles. We also provide the insurance industry with professional claims outsourcing and recycled parts locating services via an extensive network of third party suppliers of used vehicle parts.

We provide solutions for all aspects of the salvage auction process, including:

- Auction services, such as registering vehicles, clearing of funds, reporting sales results and pre-sale lineups to customers, paying third party storage centers for the release of vehicles and the physical auctioning of the vehicles by licensed auctioneers.
- Inbound and outbound logistics administration with actual services provided by both third party carriers and our auctions.
- Other services including vehicle inspections, evaluations, titling, settlement administration, drive through damage

Used Vehicle Auctions	City	State/ Province	Number of Auction Lanes
United States			
ADESA Birmingham	Moody	Alabama	10
ADESA Phoenix	Chandler	Arizona	12
ADESA Little Rock (a)	North Little Rock	Arkansas	10
ADESA Golden Gate	Tracy	California	12
ADESA Los Angeles (b)	Mira Loma	California	6
ADESA Sacramento	Sacramento	California	5
ADESA San Diego (a)	San Diego	California	6
ADESA Colorado Springs	Colorado Springs	Colorado	5
ADESA Jacksonville (c)	Jacksonville	Florida	6
ADESA Ocala	Ocala	Florida	5
ADESA Orlando-Sanford	Sanford	Florida	8
ADESA Tampa	Tampa	Florida	8
ADESA Atlanta (a)	Fairburn	Georgia	8
ADESA Indianapolis	Plainfield	Indiana	10
ADESA Southern Indiana	Edinburgh	Indiana	3
ADESA Des Moines	Grimes	Iowa	5
ADESA Lexington	Lexington	Kentucky	6
ADESA Shreveport	Shreveport	Louisiana	5
ADESA Boston	Framingham	Massachusetts	11
ADESA Concord (c)	Acton	Massachusetts	5
ADESA Lansing	Dimondale	Michigan	5
ADESA Kansas City	Lee's Summit	Missouri	7
ADESA St. Louis	Barnhart	Missouri	3
ADESA New Jersey	Manville	New Jersey	8
ADESA Buffalo (c)	Akron	New York	10
ADESA Long Island	Yaphank	New York	6
ADESA Charlotte	Charlotte	North Carolina	10
ADESA Cincinnati/Dayton	Franklin	Ohio	8
ADESA Cleveland	Northfield	Ohio	8
ADESA Tulsa	Tulsa	Oklahoma	6
ADESA Pittsburgh	Mercer	Pennsylvania	8
ADESA Knoxville	Lenoir City	Tennessee	6
ADESA Memphis	Memphis	Tennessee	6
ADESA Austin (a)	Austin	Texas	6
ADESA Dallas	Mesquite	Texas	8
ADESA Houston	Houston	Texas	8
ADESA San Antonio	San Antonio	Texas	8
ADESA Seattle	Auburn	Washington	4
ADESA Wisconsin	Portage	Wisconsin	5
Canada			
ADESA Calgary	Airdrie	Alberta	4
ADESA Edmonton (c)	Nisku	Alberta	5
ADESA Vancouver (a,c)	Richmond	British Columbia	7
CAG Vancouver (a)	Surrey	British Columbia	2
ADESA Winnipeg	Winnipeg	Manitoba	4
ADESA Moncton	Moncton	New Brunswick	2
ADESA St. John's (a)	St. John's	Newfoundland	1
ADESA Halifax (c)	Enfield	Nova Scotia	5
ADESA Kitchener	Ayr	Ontario	4
ADESA Ottawa (c)	Vars	Ontario	5
ADESA Toronto	Brampton	Ontario	8
ADESA Montreal	St. Eustache	Quebec	12
ADESA Saskatoon (a)	Saskatoon	Saskatchewan	2
Mexico			
ADESA Mexico (d)	Mexico City		

(a) Leased auction facilities. (See Note 15.)
(b) We currently lease part of the property on which this auction is located.
(c) Shares facilities with salvage auction at the same location.
(d) Holds auctions at one of our customer's facilities in Mexico City, Mexico.

Salvage Vehicle Auctions	City	State/ Province	Total Acreage
United States			
ADESA Impact – Fremont	Fremont	California	63
ADESA Impact – Jacksonville (a)	Jacksonville	Florida	6
ADESA Impact – Miami (b)	Opa-Locka	Florida	29
ADESA Impact – Orlando (b)	Orlando	Florida	8
ADESA Impact – Clinton	Clinton	Maine	7
ADESA Impact – Saco	Saco	Maine	9
ADESA Impact – Concord (a)	Acton	Massachusetts	10
ADESA Impact – Taunton	East Taunton	Massachusetts	29
ADESA Impact – Salem (c)	Salem	New Hampshire	13
ADESA Impact – Albany	Colonie	New York	25
ADESA Impact – Buffalo (a)	Akron	New York	15
ADESA Impact – Long Island (b)	Medford	New York	4
ADESA Impact – Montgomery (a)	Rock Tavern	New York	64
ADESA Impact – Clayton	Clayton	North Carolina	21
ADESA Impact – Rhode Island	East Providence	Rhode Island	15
ADESA Impact – Vermont	Essex	Vermont	28
Canada			
Impact Calgary (b)	Calgary	Alberta	10
Impact Edmonton (a,b)	Nisku	Alberta	10
Impact Vancouver (a,b)	Richmond	British Columbia	3
Impact Moncton (b)	Moncton	New Brunswick	8
Impact Halifax (a,b)	Enfield	Nova Scotia	6
Impact Hamilton (b)	Hamilton	Ontario	12
Impact London (b)	London	Ontario	17
Impact Toronto (b)	Stouffville	Ontario	28
Impact Sudbury (d)	Sudbury	Ontario	10
Impact Ottawa (a,b)	Vars	Ontario	9
Impact Montreal (b,e)	Les Cedres	Quebec	50

(a) Shares facilities with ADESA used vehicle auction at the same location.
(b) Leased auction facilities. (See Note 15.)
(c) We currently lease part of the property on which this auction is located.
(d) Impact Auto owns 50% of this auction facility.
(e) Holds a monthly auction at an independent auction facility in Quebec City, Quebec.

assessment centers, claims auditing, recycled parts locating and a national call center.

- Internet-based solutions, including on-line bulletin board auctions and on-line live auctions running simultaneously with our physical auctions.

Each of these services may also be purchased separately from the auction process.

Dealer Financing

AFC primarily provides short-term inventory-secured financing, known as floorplan financing, for used vehicle dealers in North America who purchase vehicles from our auctions, independent auctions, auctions affiliated with other auction networks and outside sources. In 2003 approximately 85% of the vehicles floorplanned by AFC were vehicles purchased by dealers at auction. AFC has 80 loan production offices at or near vehicle auctions across North America and arranged 950,000 loan transactions in 2003 (946,000 in 2002; 904,000 in 2001). Our ability to provide floorplan financing facilitates the growth of vehicle sales at auction, and also allows us to have a larger role in the entire vehicle redistribution industry.

AFC's procedures and proprietary computer-based system enable us to manage our credit risk by following each loan from origination to payoff, while expediting services through its branch network. Our approximately 8,200 active accounts (those accounts with financing for at least one vehicle outstanding), had an average line of credit of $112,000. An average of nine vehicles were floorplanned per active dealer with an approximate average value of $6,500 per vehicle. Up to 12,000 dealers utilize their lines of credit during any twelve month period.

AFC offices are conveniently located at or within close proximity of our auctions and other auctions, which allows dealers to reduce transaction time by providing immediate payment for vehicles purchased at auction. On-site financing also enables AFC to share its information with auction representatives regarding the financing capacity of customers, thereby increasing the purchasing potential at auctions. Of AFC's 80 offices in North America, 58 are physically located at auction facilities. Each of the remaining 22 AFC offices is

strategically located in close proximity to at least one of the auctions that it services. In addition, AFC has the ability to send finance representatives on-site to most approved independent auctions during auction sale-days. Geographic proximity to our customers also gives our employees the ability to stay in close contact with our outstanding accounts, thereby better enabling them to manage credit risk.

Every floorplan financed vehicle is treated as an individual loan. Typically, AFC assesses a floorplan fee at the inception of a loan and collects the fee along with interest (accrued daily) when the loan is paid in full. AFC generally only allows one loan per vehicle and permits payoffs to occur with only one check per vehicle. In addition, AFC holds title or other evidence of ownership to all vehicles which are floorplanned, except for vehicles floorplanned in Michigan. Typical loan terms are 30 or 45 days, each with a possible curtailment extension. For an additional fee, the curtailment extension allows the dealer to extend the duration of the loan beyond the original term for another 30 to 45 days if the dealer makes an upfront payment towards principal, interest and fees.

The extension of a credit line to a dealer starts with the underwriting process. Credit lines up to $150,000 are extended using a proprietary scoring model developed internally by AFC with no requirement for financial statements. Credit lines in excess of $150,000 may be extended using underwriting guidelines which require dealership and personal financial statements and tax returns. The underwriting of each line of credit requires an analysis, write-up and recommendation by the credit department and final review by a credit committee.

AFC takes a security interest in each financed vehicle, and collateral management is an integral part of day-to-day operations at each AFC branch and its Corporate headquarters. AFC's proprietary computer-based system facilitates collateral management by providing real time access to dealer information and enables our branch personnel to manage potential collection issues as soon as they arise. Restrictions are automatically placed on customer accounts in the event of a delinquency, insufficient funds received or poor audit results. Branch personnel are proactive in managing collateral by monitoring loans and notifying dealers that payments are coming due. In addition, routine audits, or lot checks, are performed by an affiliated company. Poor results from lot checks typically require branch personnel to take actions to determine the status of missing collateral, including visiting the dealer personally, verifying units held off-site and collecting payments for units sold. In some instances an audit may identify a troubled account which could cause our collections department to become involved.

AFC operates four divisions which are organized into ten regions in North America. Each division and region is monitored by managers who oversee daily operations. At the corporate level, AFC employs full-time collection specialists and collection attorneys who are assigned to specific regions and monitor collection activity for these areas. Collection specialists work closely with the branches to track trends before an account becomes a troubled account and to determine, together with collection attorneys, the best strategy to secure the collateral once a troubled account is identified.

Once a new customer is extended credit, we emphasize service, growth and management. All AFC employees at the management level participate in a two-stage interactive training program at Automotive Services' corporate headquarters that allows us to provide consistent services to our customers and consistent monitoring of our accounts at local, regional and central levels.

The Eligible Active Dealers table depicts a range of the lines of credit available to eligible dealers.

As of December 31, 2003 no single line of credit accounted for more than 10% of the total credit extended by AFC. AFC's top five active dealers represented a total committed credit of $93 million with a total outstanding principal amount of $31 million. The single largest committed line of credit granted by AFC is for $45 million, for which the obligor had $3.5 million outstanding on December 31, 2003. This obligor operates outside of AFC's normal floorplanning arrangements with specific covenants that must be maintained, and borrows on a revolving based line of credit with advances based on eligible inventory.

AFC's five largest write-offs for the past five years amounted to $3.8 million in aggregate, of which $1.4 million was recovered through ongoing collection activity as well as insurance claims.

Eligible Active Dealers – 2003

Available Line of Credit	Number of Eligible Active Dealers	Number of Dealers with Outstanding Balances	Aggregate Managed Principal Amount Outstanding as of December 31, 2003
Less than $150,000	11,337	7,648	$320,787,232
$150,001 to $500,000	512	495	102,780,909
$500,001 to $2,500,000	93	92	61,455,681
$2,500,001 to $5,000,000	6	6	11,998,355
$5,000,001 to $10,000,000	1	1	5,104,360
$10,000,001 and Greater	2	2	16,036,280
Total	11,951	8,244	$518,162,817

Competition

We are the only company to offer both used vehicle and salvage auctions, floorplan financing for used vehicle dealers and a wide array of related vehicle redistribution services. In the used vehicle auction industry, we compete with Manheim Auctions, Inc. (Manheim), a subsidiary of Cox Enterprises, Inc., as well as several smaller chains of auctions, and independent auctions, some of which are affiliated through their membership in an industry organization named ServNet®. Due to our national presence, competition is strongest with Manheim for the supply of used vehicles from national level accounts of institutional customers. Although the supply of these vehicles is dispersed among all of the auctions in the used vehicle market, we compete most heavily with the independent auctions (as well as Manheim and all others in the market) for the supply of vehicles from dealers.

Due to the increased visibility of the Internet as a marketing and distribution channel, new competition has arisen recently from Internet-based companies and our own customers who have historically redistributed vehicles through various channels including auctions. Direct sales of vehicles by institutional customers and large dealer groups through internally developed or third party on-line auctions have largely replaced telephonic and other non-auction methods, becoming an increasing portion of overall used vehicle redistribution. The extent of use of direct, on-line systems varies by customer and, based upon our estimates, currently comprises approximately 3% to 5% of overall used vehicle auction sales. Typically, these on-line auctions serve to redistribute vehicles that have come off lease. In addition, some of our competitors have begun to offer on-line auctions as all or part of their auction business and other on-line auction companies now include used vehicles among the products offered at their auctions. On-line auctions or other methods of redistribution may diminish both the quality and quantity and reduce the value of vehicles sold through traditional auction facilities.

In the salvage auction services industry, we compete with Copart, Inc., Insurance Auto Auctions, Inc., independent auctions, some of which are affiliated through their membership in an industry organization named Sadisco®, and a limited number of used vehicle auctions that regularly redistribute salvage vehicles. Additionally, some dismantlers of salvage vehicles and Internet-based companies have entered the market, thus providing alternate avenues for sellers to redistribute salvage vehicles. We believe further consolidation of the salvage auction service industry will occur and are evaluating various means by which we can continue our growth plan. Through strategic acquisitions, shared facilities with our used vehicle auctions and greenfield expansion, we believe our salvage auction service business can become a prominent salvage services auction provider to the insurance industry in the United States.

In Canada we are the largest provider of used and salvage vehicle auction services. Our competitors include vehicle recyclers and dismantlers, independent vehicle auctions, brokers, Manheim and on-line auction companies. We believe we are strategically positioned in this market by providing a full array of value-added services to our customers including auctions and related services, on-line programs, data analyses, and consultation.

The used vehicle inventory floorplan financing sector is characterized by diverse and fragmented competition. AFC primarily provides short-term dealer floorplan financing of wholesale vehicles to independent vehicle dealers in North America. AFC's competition includes Manheim Automotive Financial Services, other specialty lenders, banks and other financial institutions. AFC competes primarily on the basis of quality of services, convenience of payment, scope of services offered, and historical and consistent commitment to the sector.

Employees

At December 31, 2003 Automotive Services had approximately 11,200 employees, with 9,000 located in the United States and Mexico and 2,200 located in Canada. About 64% of Automotive Services' work force consists of full-time employees. Currently none of Automotive Services' employees participate in collective bargaining agreements. In addition to our work force of employees, Automotive Services also utilizes temporary labor services to assist in handling the vehicles consigned during periods of peak volume and staff shortages. Nearly all of Automotive Services' auctioneers are contract laborers providing their services for a daily or weekly rate. Many of the services Automotive Services provides are outsourced to third party providers that perform the services either on-site or off-site. The use of third party providers depends upon the resources available at each auction facility as well as peaks in the volume of vehicles offered at auction.

Vehicle Regulation

Automotive Services' operations are subject to regulation, supervision and licensing under various U.S. or Canadian federal, state, provincial and local statutes, ordinances and regulations. Each auction is subject to laws in the state or province in which it operates which regulate auctioneers and/or vehicle dealers. Some of the transport vehicles used at our auctions are regulated by the U.S. Department of Transportation or the Canadian Transportation Agency. The acquisition and sale of salvage and theft recovered vehicles is regulated by governmental agencies in each of the locations in which we operate. In many states and provinces, regulations require that a salvage vehicle be forever "branded" with a salvage notice in order to notify prospective purchasers of the vehicle's previous salvage status. Some state, provincial and local regulations also limit who can purchase salvage vehicles, as well as determine whether a salvage vehicle can be sold as rebuildable or must be sold for parts only. Such regulations can reduce the number of potential buyers of vehicles at salvage auctions. In addition to the regulation of the sales and acquisition of vehicles, we are also subject to various local zoning requirements with regard to the location and operation of our auction and storage facilities.

Environmental Matters

Certain businesses in our Automotive Services segment are subject to regulation by various U.S. and Canadian federal, state, provincial and local authorities concerning air quality, water quality, solid wastes and other environmental matters. In the vehicle redistribution industry, large numbers of vehicles, including damaged vehicles at salvage auctions, are stored at auction facilities and, during that time, releases of fuel, motor oil and other fluids may occur, resulting in soil, air, surface water or groundwater contamination. In addition, our facilities generate and/or store petroleum products and other hazardous materials, including wastewater waste solvents and used oil, and body shops at our facilities may release harmful air emissions associated with painting. We could incur substantial expenditures for preventative, investigative or remedial action and could be exposed to liability arising from our operations, contamination by previous users of our acquired facilities, or the disposal of our waste at off-site locations. We consider these businesses to be in substantial compliance with those environmental regulations currently applicable to their operations and believe all necessary permits to conduct such operations have been obtained. We 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. These accruals are adjusted periodically as assessment and remediation efforts progress, or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the balance sheet at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. Costs related to environmental contamination treatment and cleanup are charged to expense.

ADESA Impact Taunton Facility. In December 2003 the Massachusetts Department of Environmental Protection (MDEP) identified ADESA Impact as a potentially responsible party regarding contamination of several private drinking water wells in a residential development that abuts the Taunton, Massachusetts salvage vehicle auction facility. The wells had elevated levels of methyl tertiary-butyl ether (MTBE). MTBE is an oxygenating additive in gasoline to reduce harmful emissions. The EPA has identified MTBE as a possible carcinogen. ADESA Impact engaged GeoInsight, an environmental services firm, to conduct tests of its soil and groundwater at the salvage vehicle auction site, and we are providing bottled water to some affected residents.

GeoInsight prepared an immediate response action (IRA) plan, which is required by the MDEP to determine the extent of the environmental impact and define activities to prevent further environmental contamination. The IRA plan, which was filed on January 24, 2004, describes the initial activities ADESA Impact performed, and proposes additional measures that it will use to further assess the existence of any imminent hazard to human health. In addition, as required by the MDEP, ADESA Impact is conducting an analysis to identify sensitive receptors that may have been affected, including area schools and municipal wells. GeoInsight does not believe that an imminent hazard condition exists at the Taunton site; however, the investigation and assessment of site conditions are ongoing.

In December 2003 GeoInsight collected soil samples, conducted groundwater tests and provided oversight for the installation of monitoring wells in various locations on and adjacent to the property adjoining the residential community. The results of the soil and water tests indicated levels of MTBE exceeding MDEP standards. In January 2004 we collected air samples from two residences that we identified as having elevated drinking water concentrations of MTBE. We have determined that inhalation of, or contact exposure to, this air poses minimal risk to human health. In response to our empirical findings, we have proposed to the MDEP that we install granular activated carbon filtration systems in the approximately 30 affected residences.

ADESA Impact is preparing an IRA status report that must be submitted to the MDEP by March 30, 2004, and will continue to prepare additional reports as necessary. As of December 31, 2003 ADESA Impact has accrued $0.7 million to cover the costs associated with ongoing testing, remediation and cleanup of the site. We have filed a claim under our pollution liability insurance plan with respect to this matter. We and our insurer are currently discussing the availability of insurance coverage for this claim.

Investments and Corporate Charges

Our Investments and Corporate Charges segment consists of real estate operations, investments in emerging technologies related to the electric utility industry and corporate charges. Corporate Charges represent general corporate expenses, including interest, not specifically related to any one business segment. The discussion below summarizes the major components of the Investments and Corporate Charges segment. Statistical information is presented as of December 31, 2003 unless otherwise noted. All subsidiaries are wholly owned unless otherwise specifically indicated.

Real Estate Operations

Our real estate operations include **Cape Coral Holdings, Inc.; Palm Coast Land, LLC; Palm Coast Forest, LLC; Tomoka Holdings, LLC; Winter Haven Citi Centre, LLC;** and an 80% ownership in **Lehigh**. Through subsidiaries, we own Florida real estate operations in five different locations:

- Lehigh Acres with 890 acres of residential and commercial land, east of Fort Myers, Florida;
- Cape Coral, located west of Fort Myers, Florida, with 160 acres of mostly commercially zoned land;
- Palm Coast, a planned community between St. Augustine and Daytona Beach, Florida, with 12,000 acres of residential, commercial and industrial land;
- Tomoka, located near Ormand Beach, Florida with 6,200 acres of property; and
- Winter Haven, located in central Florida, with a retail shopping center.

Our real estate operations may, from time to time, acquire packages of diversified properties at low cost, then add value through entitlements and infrastructure enhancements, and sell the properties at current market prices.

Emerging Technology Investments

From 1985 through 2003 we have invested more than $50 million in start-up companies which are developing technologies that may be utilized by the electric utility industry. We are committed to invest an additional $4.8 million at various times through 2007. The investments were first made through emerging technology funds (Funds) initiated by other electric utilities and us. We have also made investments directly in privately held companies.

The Funds have made investments in companies that develop advanced technologies to be used by the utility industry, including electrotechnologies, renewable energy technologies, and software and communications technologies related to utility customer support systems.

Companies in the Funds' portfolios may complete initial public offerings (IPOs), and the Funds, may in some instances, distribute publicly tradable shares to us. Some restrictions on sales may apply, including, but not limited to, underwriter lock-up periods that typically extend for 180 days following an IPO. As companies included in our emerging technology investments are sold, we will recognize a gain or loss.

Since going public, the market value of the publicly traded investments has experienced significant volatility. During 2003 we sold at a net loss the remainder of our direct investment in the companies that have gone public.

We also have several minority investments in the Funds and privately-held start-up companies. These investments are accounted for under the cost method and included with Investments on our consolidated balance sheet. The total carrying value of these investments was $37.5 million at December 31, 2003 ($38.7 million at December 31, 2002).

Our policy is to review these investments quarterly for impairment by assessing such factors as continued commercial viability of products, cash flow and earnings. Any impairment would reduce the carrying value of the investment.

Environmental Matters

Certain businesses included in our Investments and Corporate Charges segment are subject to regulation by various federal, state and local authorities concerning air quality, water quality, solid wastes and other environmental matters. We consider these businesses to be in substantial compliance with those environmental regulations currently applicable to their operations and believe all necessary permits to conduct such operations have been obtained. We 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. These accruals are adjusted periodically as assessment and remediation efforts progress, or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the balance sheet at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. Costs related to environmental contamination treatment and cleanup are charged to expense.

EXECUTIVE OFFICERS OF THE REGISTRANT

Executive Officers	Initial Effective Date
David G. Gartzke, Age 60	
Chairman - ALLETE;	
Chairman, President and Chief Executive Officer - ALLETE Automotive Services, Inc.;	
Chairman, President and Chief Executive Officer - ADESA, Inc.; and	
Chairman and Chief Executive Officer - ADESA Corporation	January 23, 2004
Chairman - ALLETE;	
Chairman, President and Chief Executive Officer - ALLETE Automotive Services, Inc.; and	
Chairman and Chief Executive Officer - ADESA Corporation	January 21, 2004
Chairman, President and Chief Executive Officer - ALLETE;	
Chairman, President and Chief Executive Officer - ALLETE Automotive Services, Inc.; and	
Chairman and Chief Executive Officer - ADESA Corporation	July 7, 2003
Chairman, President and Chief Executive Officer - ALLETE	January 23, 2002
President - ALLETE	August 28, 2001
Senior Vice President - Finance and Chief Financial Officer - ALLETE	December 1, 1994
Donald J. Shippar, Age 55	
President and Chief Executive Officer - ALLETE	January 21, 2004
Executive Vice President - ALLETE and	
President - Minnesota Power	May 13, 2003
President and Chief Operating Officer - Minnesota Power	January 1, 2001
Deborah A. Amberg, Age 38	
Vice President, General Counsel and Secretary	March 8, 2004
Brenda J. Flayton, Age 48	
Vice President - Human Resources - ALLETE and	
Vice President - Human Resources - ALLETE Automotive Services, Inc.	October 22, 2003
Vice President - Human Resources - ALLETE	July 22, 1998
James P. Hallett, Age 50	
Executive Vice President - ALLETE;	
Vice President - ADESA, Inc.; and	
President and Chief Operating Officer - ADESA Corporation, LLC	March 4, 2004
Executive Vice President - ALLETE;	
Vice President - ADESA, Inc.; and	
President and Chief Operating Officer - ADESA Corporation	March 1, 2004
Executive Vice President - ALLETE and	
President and Chief Operating Officer - ADESA Corporation	January 30, 2004
Executive Vice President - ALLETE and	
President - ADESA Corporation	July 7, 2003
Executive Vice President - ALLETE and	
President and Chief Executive Officer - ALLETE Automotive Services, Inc.	November 5, 2001
Executive Vice President - ALLETE and Chief Executive Officer - ADESA Corporation	October 1, 2001
Executive Vice President - ALLETE and	
President and Chief Executive Officer - ADESA Corporation	April 23, 1997
Philip R. Halverson, Age 55	
Retired	March 5, 2004
Vice President, General Counsel and Secretary	January 1, 1996
Mark A. Schober, Age 48	
Senior Vice President and Controller	February 1, 2004
Vice President and Controller	April 18, 2001
Controller	March 1, 1993
Timothy J. Thorp, Age 49	
Vice President - Investor Relations and Corporate Communications	November 16, 2001
James K. Vizanko, Age 50	
Senior Vice President, Chief Financial Officer and Treasurer	January 21, 2004
Vice President, Chief Financial Officer and Treasurer	August 28, 2001
Vice President and Treasurer	April 18, 2001
Treasurer	March 1, 1993

PART I

All of the executive officers have been employed by us for more than five years in executive or management positions. In the five years prior to election to the positions shown on the previous page, Ms. Amberg was senior attorney, Ms. Flayton was director of human resources, Mr. Shippar was Minnesota Power's chief operating officer, senior vice president of customer service and delivery, and vice president of transmission and distribution, and Mr. Thorp was director of investor relations.

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

The present term of office of the executive officers listed on the previous page extends to the first meeting of our Board of Directors after the next annual meeting of shareholders. Both meetings are scheduled for May 11, 2004.

Item 2. Properties

Properties are included in the discussion of our business in Item 1. and are incorporated by reference herein.

Item 3. Legal Proceedings

Material legal and regulatory proceedings are included in the discussion of our business in Item 1. 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, compliance with regulations, rate base and cost of service issues, among other things. While the resolution of such matters could have a material effect on earnings and cash flows in the year of resolution, none of these matters are expected to change materially our present liquidity position, nor have a material adverse effect on our financial condition.

The staff of the SEC is conducting an informal inquiry relating to our internal audit function, internal financial reporting and the loan loss methodology at AFC. We are fully and voluntarily cooperating with the informal inquiry, and the SEC staff has not asserted that we have acted improperly or illegally. Although we cannot predict the length, scope or results of the informal inquiry, based upon extensive review by the Audit Committee of our Board of Directors with the assistance of independent counsel and our independent auditors, we believe that we have acted appropriately and that this inquiry will not result in action that has a material adverse impact on us or our reported results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of 2003.

PART II

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

We have paid dividends without interruption on our common stock since 1948. A quarterly dividend of $0.2825 per share on our common stock will be paid on March 1, 2004 to the holders of record on February 16, 2004. Our common stock is listed on the New York Stock Exchange under the symbol ALE and our CUSIP number is 018522102. Dividends paid per share, and the high and low prices for our common stock for the periods indicated as reported by the New York Stock Exchange on its NYSEnet website, are in the accompanying chart.

The amount and timing of dividends payable on our common stock are within the sole discretion of our Board of Directors. In 2003 we paid out 40% of our per share earnings in dividends.

Our Articles of Incorporation, and Mortgage and Deed of Trust contain provisions which under certain circumstances would restrict the payment of common stock dividends. As of December 31, 2003 no retained earnings were restricted as a result of these provisions. At March 1, 2004 there were approximately 37,000 common stock shareholders of record.

Quarter		Price Range High	Price Range Low	Dividends Paid
2003 –	First	$24.05	$18.75	$0.2825
	Second	26.70	20.50	0.2825
	Third	27.86	25.45	0.2825
	Fourth	31.00	27.05	0.2825
	Annual Total			$1.13
2002 –	First	$29.43	$24.25	$0.275
	Second	31.10	27.09	0.275
	Third	27.62	18.50	0.275
	Fourth	23.80	18.65	0.275
	Annual Total			$1.10

PART II

Item 6. Selected Financial Data

Operating results of our Water Services businesses, our vehicle transport and import businesses, and our retail stores are included in discontinued operations and, accordingly, amounts have been adjusted for all periods presented. Common share and per share amounts have also been adjusted for all periods to reflect our March 2, 1999 two-for-one common stock split.

	2003	2002	2001	2000	1999	1998
Millions						
Balance Sheet						
Assets						
Current Assets	$ 680.5	$ 629.6	$ 853.3	$ 677.2	$ 506.0	$ 444.6
Discontinued Operations — Current	14.9	28.8	42.2	41.5	43.7	29.1
Property, Plant and Equipment	1,499.0	1,364.7	1,323.3	1,201.1	1,003.4	955.5
Investments	204.6	170.9	155.4	128.7	212.0	277.3
Goodwill	511.0	502.0	491.9	472.8	181.0	169.8
Other Assets	103.4	105.1	106.1	87.3	82.4	91.2
Discontinued Operations — Other	87.9	346.1	310.3	305.4	284.1	241.4
	$3,101.3	$3,147.2	$3,282.5	$2,914.0	$2,312.6	$2,208.9
Liabilities and Shareholders' Equity						
Current Liabilities	$ 476.7	$ 708.5	$ 658.6	$ 661.9	$ 366.1	$ 326.3
Discontinued Operations — Current	49.5	29.7	45.9	45.1	32.2	19.7
Long-Term Debt	747.7	696.4	968.9	852.3	613.0	575.7
Mandatorily Redeemable Preferred Securities	–	75.0	75.0	75.0	75.0	75.0
Other Liabilities	322.2	277.4	270.5	257.5	265.3	286.1
Discontinued Operations — Other	45.0	127.8	119.8	121.4	123.7	109.0
Redeemable Preferred Stock	–	–	–	–	20.0	20.0
Shareholders' Equity	1,460.2	1,232.4	1,143.8	900.8	817.3	797.1
	$3,101.3	$3,147.2	$3,282.5	$2,914.0	$2,312.6	$2,208.9
Income Statement						
Operating Revenue						
Energy Services	$ 659.6	$ 626.0	$ 618.7	$ 586.4	$553.1	$558.9
Automotive Services	922.3	835.8	832.1	522.6	383.2	305.5
Investments	36.9	32.5	74.8	77.4	57.8	55.5
	1,618.8	1,494.3	1,525.6	1,186.4	994.1	919.9
Expenses						
Fuel and Purchased Power	252.5	234.8	233.1	229.0	200.2	205.7
Operations	1,064.7	997.9	1,007.3	725.3	595.8	538.7
Interest Expense	66.6	70.5	83.0	67.1	57.8	62.9
	1,383.8	1,303.2	1,323.4	1,021.4	853.8	807.3
Operating Income Before Capital Re and ACE	235.0	191.1	202.2	165.0	140.3	112.6
Income (Loss) from Investment in Capital Re and Related Disposition of ACE	–	–	–	48.0	(34.5)	15.2
Operating Income from Continuing Operations	235.0	191.1	202.2	213.0	105.8	127.8
Income Tax Expense	91.9	72.2	73.3	76.1	50.0	48.2
Income from Continuing Operations	143.1	118.9	128.9	136.9	55.8	79.6
Income from Discontinued Operations	93.3	18.3	9.8	11.7	12.2	8.9
Net Income	236.4	137.2	138.7	148.6	68.0	88.5
Preferred Dividends	–	–	–	0.9	2.0	2.0
Earnings Available for Common Stock	236.4	137.2	138.7	147.7	66.0	86.5
Common Stock Dividends	93.2	89.2	81.8	74.5	73.0	65.0
Retained (Deficit) in the Business	$ 143.2	$ 48.0	$ 56.9	$ 73.2	$ (7.0)	$ 21.5

PART II

	2003	2002	2001	2000	1999	1998
Shares Outstanding — Millions						
Year-End	87.3	85.6	83.9	74.7	73.5	72.3
Average (a)						
Basic	82.8	81.1	75.8	69.8	68.4	64.0
Diluted	83.3	81.7	76.5	70.1	68.6	64.2
Diluted Earnings Per Share						
Continuing Operations	$1.72	$1.46 (c)	$1.68	$1.95 (f)	$0.79 (f)	$1.21
Discontinued Operations	1.12 (b)	0.22 (d)	0.13 (e)	0.16	0.18	0.14
	$2.84	$1.68	$1.81	$2.11	$0.97	$1.35
Return on Common Equity	17.7%	11.4%	13.3%	17.1%	8.3%	12.4%
Common Equity Ratio	64.4%	51.7%	49.9%	46.3%	49.3%	49.9%
Dividends Paid Per Share	$1.13	$1.10	$1.07	$1.07	$1.07	$1.02
Dividend Payout	40%	66%	59%	51%	110%	76%
Book Value Per Share at Year-End	$16.73	$14.39	$13.63	$12.06	$10.97	$10.86
Market Price Per Share						
High	$31.00	$31.10	$26.89	$25.50	$22.09	$23.13
Low	$18.75	$18.50	$20.19	$14.75	$16.00	$19.03
Close	$30.60	$22.68	$25.20	$24.81	$16.94	$22.00
Market/Book at Year-End	1.83	1.58	1.85	2.06	1.54	2.03
Price Earnings Ratio at Year-End	10.8	13.5	13.9	11.8	17.5	16.3
Dividend Yield at Year-End	3.7%	4.9%	4.2%	4.3%	6.3%	4.6%
Employees	13,115	14,181	13,763	12,633	8,246	7,003
Net Income						
Energy Services	$ 42.4	$ 41.8 (c)	$ 51.7	$ 44.5	$ 46.0	$48.3
Automotive Services	114.8	94.2	74.8	49.9	40.3	24.6
Investments and Corporate Charges	(14.1)	(17.1)	2.4	42.5 (f)	(30.5) (f)	6.7
Continuing Operations	143.1	118.9	128.9	136.9	55.8	79.6
Discontinued Operations	93.3 (b)	18.3 (d)	9.8 (e)	11.7	12.2	8.9
	$236.4	$137.2	$138.7	$148.6	$ 68.0	$88.5
Electric Customers — Thousands	149.0	147.0	145.0	144.0	139.7	138.1
Electric Sales — Millions of MWh						
Regulated Utility	11.1	11.1	10.9	11.7	11.3	12.0
Nonregulated	1.5	1.2	0.2	0.2	–	–
Company Use and Losses	(0.9)	(0.5)	0.5	0.5	0.5	0.2
	11.7	11.8	11.6	12.4	11.8	12.2
Regulated Utility Power Supply — Millions of MWh						
Steam Generation	7.1	7.2	6.9	6.4	6.2	6.3
Hydro Generation	0.4	0.5	0.5	0.5	0.7	0.6
Long-Term Purchase — Square Butte	2.3	2.3	1.9	2.4	2.3	2.1
Purchased Power	1.9	1.8	2.3	3.1	2.6	3.2
	11.7	11.8	11.6	12.4	11.8	12.2
Coal Sold — Millions of Tons	4.3	4.6	4.1	4.4	4.5	4.2
Vehicles Sold — Thousands						
Used	1,810	1,741	1,761	1,286	1,037	897
Salvage	191	175	148	33	–	–
Loan Transactions — Thousands	950	946	904	795	695	531
Capital Expenditures — Millions	$136.3	$201.2	$149.2	$168.7	$99.7	$80.8

(a) Excludes unallocated ESOP shares.
(b) Included a $71.6 million, or $0.86 per share, after-tax gain on the sale of substantially all our Water Services businesses.
(c) Included a $5.5 million, or $0.07 per share, charge related to the indefinite delay of a generation project in Superior, Wisconsin.
(d) Included $3.9 million, or $0.05 per share, in charges to complete the exit from the vehicle transport business and the retail stores.
(e) Included a $4.4 million, or $0.06 per share, estimated charge to exit the vehicle transport business.
(f) In 2000 we recorded a $30.4 million, or $0.44 per share, gain on the sale of 4.7 million shares of ACE that we received in 1999 when Capital Re merged with ACE. As a result of the merger, in 1999 we recorded a $36.2 million, or $0.52 per share, charge.

PART II

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

Consolidated Overview

During 2003 our efforts focused on our two core businesses, Energy Services and Automotive Services. After a lengthy review of our strategic alternatives, in October 2003 we announced plans to spin off our Automotive Services business. We expect the spin-off to occur in the third quarter of 2004. This decision reflects our intention to maximize the long-term value of each business by creating two separate, more focused companies, and create long-term shareholder value. (See Outlook.) We also substantially completed the sale of our Water Services businesses. Proceeds from the sale of our water assets were used to pay down debt which strengthened our balance sheet.

Net income and diluted earnings per share for 2003 increased 72% and 69% from 2002, respectively. Gains recognized in 2003 on the sale of substantially all our water and wastewater systems in Florida contributed to increased earnings. Net income and diluted earnings per share from continuing operations for 2003 increased 20% and 18% from 2002, respectively. A strong performance by our Automotive Services businesses in 2003 increased earnings from continuing operations.

Millions Except Per Share Amounts	**2003**	**2002**	**2001**
Operating Revenue			
Energy Services	$ 659.6	$ 626.0	$ 618.7
Automotive Services	922.3	835.8	832.1
Investments	36.9	32.5	74.8
	$1,618.8	$1,494.3	$1,525.6
Operating Expenses			
Energy Services	$ 590.6	$ 560.5	$ 534.6
Automotive Services	732.7	681.7	713.1
Investments and Corporate Charges	60.5	61.0	75.7
	$1,383.8	$1,303.2	$1,323.4
Net Income			
Energy Services	$ 42.4	$ 41.8	$ 51.7
Automotive Services	114.8	94.2	74.8
Investments and Corporate Charges	(14.1)	(17.1)	2.4
Continuing Operations	143.1	118.9	128.9
Discontinued Operations	93.3	18.3	9.8
	$236.4	$137.2	$138.7
Diluted Average Shares of Common Stock	83.3	81.7	76.5
Diluted Earnings Per Share of Common Stock			
Continuing Operations	$1.72	$1.46	$1.68
Discontinued Operations	1.12	0.22	0.13
	$2.84	$1.68	$1.81
Return on Common Equity	17.7%	11.4%	13.3%

We measure performance of our operations through careful budgeting and monitoring of contributions to consolidated net income by each business segment.

Our financial results for the past three years include the following significant factors which impact the comparisons between years:

- **Sale of Water Plant Assets.** Earnings from Discontinued Operations for 2003 included a $71.6 million, or $0.86 per share, after-tax gain on the sale of substantially all our Water Services businesses.
- **Charges.** Earnings from Energy Services for 2002 included a $5.5 million, or $0.07 per share, after-tax charge related to the indefinite delay of a generation project in Superior, Wisconsin. Earnings from Discontinued Operations for 2002 included $3.9 million, or $0.05 per share, of after-tax charges to exit the vehicle transport business and the retail stores ($4.4 million, or $0.06 per share in 2001).
- **Goodwill.** Earnings from Automotive Services for 2001 included $9.9 million, or $0.13 per share, of goodwill amortization expense after tax. As required by SFAS 142, goodwill amortization was discontinued in 2002.
- **Real Estate Transaction.** Earnings from Investments for 2001 included an $11.1 million, or $0.15 per share, after-tax gain associated with our largest ever single real estate transaction.

Statistical Information	**2003**	**2002**	**2001**
Energy Services			
Millions of Kilowatthours Sold			
Regulated Utility			
Retail			
Residential	1,066	1,044	998
Commercial	1,286	1,257	1,234
Industrial	6,558	6,946	6,549
Other	79	78	75
Resale	2,155	1,807	2,086
	11,144	11,132	10,942
Nonregulated	1,462	1,149	140
	12,606	12,281	11,082
Automotive Services			
Thousands			
Vehicles Sold			
Used	1,810	1,741	1,761
Salvage	191	175	148
	2,001	1,916	1,909
Conversion Rate (a) – Used Vehicles	61.0%	59.0%	58.1%
Loan Transactions	950	946	904

(a) Conversion rate is the percentage of vehicles sold from those that were offered at auction.

Non-GAAP Measure of Liquidity. We believe earnings before interest, taxes, depreciation and amortization expense (EBITDA) provides meaningful additional information that helps us monitor and evaluate our ongoing results and trends. EBITDA should not be considered in isolation nor as a substitute for measures of liquidity prepared in accordance with GAAP which include:

Consolidated Cash Flow

For the Year Ended December 31	2003	2002	2001
Millions			
Cash from Operating Activities	$245.8	$453.0	$103.6
Cash from (for) Investing Activities	$212.3	$(244.4)	$(297.4)
Cash from (for) Financing Activities	$(470.7)	$(242.6)	$220.0

We believe EBITDA is a widely accepted measure of liquidity considered by investors, financial analysts and rating agencies. EBITDA is not an alternative to cash flow as a measure of liquidity and may not be comparable with EBITDA as defined by other companies.

EBITDA

For the Year Ended	Consolidated	Energy Services	Automotive Services	Investments and Corporate Charges
Millions				
2003				
Net Income	$236.4			
Less: Income from Discontinued Operations	93.3			
Income (Loss) from Continuing Operations	143.1	$ 42.4	$114.8	$(14.1)
Add Back: Income Tax Expense (Benefit)	91.9	26.6	74.8	(9.5)
Interest Expense	66.6	22.4	16.0	28.2
Depreciation and Amortization Expense	86.5	51.1	35.3	0.1
EBITDA	$388.1	$142.5	$240.9	$ 4.7
2002				
Net Income	$137.2			
Less: Income from Discontinued Operations	18.3			
Income (Loss) from Continuing Operations	118.9	$ 41.8	$ 94.2	$(17.1)
Add Back: Income Tax Expense (Benefit)	72.2	23.7	59.9	(11.4)
Interest Expense	70.5	21.2	21.2	28.1
Depreciation and Amortization Expense	81.7	48.8	32.8	0.1
EBITDA	$343.3	$135.5	$208.1	$ (0.3)
2001				
Net Income	$138.7			
Less: Income from Discontinued Operations	9.8			
Income from Continuing Operations	128.9	$ 51.7	$ 74.8	$ 2.4
Add Back: Income Tax Expense (Benefit)	73.3	32.4	44.2	(3.3)
Interest Expense	83.0	22.5	35.3	25.2
Depreciation and Amortization Expense	88.9	45.9	42.7	0.3
EBITDA	$374.1	$152.5	$197.0	$24.6

Net Income

Energy Services. Income from continuing operations in 2003 was up $0.6 million, or 1%, from 2002 reflecting increased sales of nonregulated generation at our Taconite Harbor facility and improved wholesale power prices.

Increased sales of nonregulated generation and higher expenses related to that generation resulted from Taconite Harbor being available for a full 12 months in 2003. Taconite Harbor generation first came online at various times during the first half of 2002. Generation secured through the Kendall County power purchase agreement began in May 2002. In total, the Kendall County facility operated at a loss in 2003 due to negative spark spreads (the differential between electric and natural gas prices) in the wholesale power market and our resulting inability to cover the fixed capacity charge on approximately 175 MW. We expect the facility to continue to generate losses until such time as spark spreads improve or we are able to enter into additional long-term capacity sales contracts.

Wholesale power prices were higher in 2003 compared to 2002 when weak wholesale power prices more than offset the positive impact of increased nonregulated megawatthour sales. In 2001 our wholesale power marketing activities were more profitable compared to 2002 due to warmer summer weather and overall market conditions.

In 2003 higher employee pension and benefit expenses, and a charge to exit our Split Rock Energy joint venture reduced income, while in 2002 a $5.5 million charge related to the indefinite delay of a generation project in Superior, Wisconsin, reduced income. Income in 2002 also included a $2.3 million one-time deferral of costs recoverable through the regulated utility fuel clause that increased income. Income in 2001 included the recovery of $2.6 million for 1998 CIP lost margins.

Automotive Services. Income from continuing operations in 2003 was up $20.6 million, or 22%, from 2002. Higher income in 2003 was attributable to an increased number of vehicles sold, fee increases, the introduction and expansion of our service offerings, lower interest expense due to lower debt balances, gains on sale of property and strong receivable portfolio management at AFC, our floorplan financing business.

At ADESA used vehicle auction facilities, vehicles sold increased 4% over 2002. Total vehicles sold at our auctions decreased in 2002 as the price spreads between new and used vehicles were disrupted by the increased manufacturer incentives on new vehicles that were first introduced following the events of September 11, 2001. The aggressive incentives offered by vehicle manufacturers lowered the cost of owning a new vehicle, which in turn depressed prices for late-model used vehicles. Sellers at used vehicle auctions tended to hold their vehicles rather than immediately accept lower prices. In addition to the incentives, the supply of program vehicles from rental repurchase programs maintained by our institutional customers were lower in 2002 due to the decrease in the sizes of rental car fleets in response to the decrease in the travel industry after September 11, 2001. The size of the rental car fleets remained at a lower level throughout 2002 as compared to the levels prior to September 11 leading to fewer turns of the fleets. Costs of assimilating the 28 used vehicle auction facilities acquired or opened in 2000 also impacted 2001 results.

At our salvage vehicle auction facilities, vehicle sales continued to increase reflecting expansion into new markets, which included adding salvage auctions at some of our used vehicle auction facilities. During 2003 ADESA Impact opened two auction facilities (two in 2002; 13 in 2001). In 2003, 9% more vehicles were sold at our salvage vehicle auction facilities than in 2002. Despite unseasonably dry weather conditions in 2002, which usually means fewer salvage vehicles, the number of vehicles sold at our salvage vehicle auction facilities was 18% higher in 2002 compared to 2001.

AFC contributed 32% of the income from Automotive Services in 2003 (37% in 2002; 40% in 2001). Income from AFC was higher in 2003 because of lower interest and bad debt expense. Interest expense decreased due to lower debt balances and rates. Bad debt expense was down reflecting improved credit quality of the receivable portfolio and strong receivable portfolio management. Loan transactions increased slightly to 950,000 in 2003. AFC managed total receivables of $539 million at December 31, 2003 ($501 million at December 31, 2002; $505 million at December 31, 2001).

As required by SFAS 142, goodwill amortization was discontinued in 2002. This mandated accounting change is a significant factor when comparing 2002 and 2001 earnings from Automotive Services. Earnings for 2001 included $9.9 million of goodwill amortization expense after tax.

Investments and Corporate Charges. Net loss in 2003 decreased $3.0 million, or 18%, from 2002. In 2003 more real estate sales were partially offset by net losses on the sale of shares we held directly in publicly-traded emerging technology investments. Financial results for 2002 included net gains on the sale of certain emerging technology investments and losses related to our trading securities portfolio which was liquidated during the second half of 2002. In 2001 our real estate operations reported strong sales including an $11.1 million gain on its largest single sale ever, and our trading securities portfolio earned a negative 1.5% after-tax annualized return prior to liquidation in 2002 compared to a positive 5.6% in 2001.

Corporate charges in 2003 reflected less interest expense due to lower debt balances and lower interest rates. In 2002 and 2001 interest expense was higher as a result of debt issued to fund strategic initiatives in early 2001. Corporate charges in 2003 also reflected costs incurred for professional services related to the business separation study, as well as higher incentive compensation expenses. Incentive compensation expenses were lower in 2002 in part due to lower 2002 earnings. In 2001 additional compensation expenses were incurred for severance packages.

Discontinued Operations included the financial results of our Water Services businesses, our vehicle transport and import businesses, and our retail stores.

Net income from Discontinued Operations in 2003 was up $75.0 million from 2002 primarily due to the sale of water and wastewater systems serving various counties and communities in Florida. A $71.6 million after-tax gain was recognized on the sale of these systems, net of all selling, transaction and employee termination benefit expenses, as well as impairment losses on certain remaining assets.

Our Water Services businesses in North Carolina reported a 14% decrease in water consumption because above normal precipitation decreased consumption in 2003.

Net income from Discontinued Operations was also higher in 2003 and 2002 due to the adoption of SFAS 144 which required suspension of depreciation on our Water Services assets. Income from Discontinued Operations included $7.5 million of depreciation expense after tax in 2001.

Net income from other discontinued operations in 2003 included a $1.3 million recovery from the settlement of a

lawsuit associated with our vehicle transport business, while net income in 2002 included $3.9 million of exit charges related to the vehicle transport business and the retail stores, and 2001 included a $4.4 million charge to exit the vehicle transport business.

2003 Compared to 2002

Energy Services

Regulated utility operations include retail and wholesale rate regulated activities under the jurisdiction of state and federal regulatory authorities. Nonregulated operations consist of nonregulated electric generation (non-rate base generation sold at market-based rates to the wholesale market), coal mining and telecommunications activities. Nonregulated generation operations consist primarily of Taconite Harbor in northern Minnesota and generation secured through the Kendall County power purchase agreement, a 15-year agreement with NRG Energy at a facility near Chicago, Illinois, ending in 2017.

Operating revenue in total was up $33.6 million, or 5%, in 2003 reflecting increases from both regulated utility and nonregulated operations. Regulated utility operating revenue was up $7.2 million, or 1%, mainly due to higher fuel clause recoveries and natural gas prices. Regulated utility kilowatthour sales were similar to last year. Fuel clause recoveries increased due to higher purchased power costs. Our 2003 equity in net income from Split Rock Energy reflected a $2.3 million charge accrued at the time we reached an agreement to withdraw from this joint venture. Nonregulated revenue increased $26.4 million, or 22%, in 2003 primarily due to increased sales of nonregulated generation at our Taconite Harbor facility, improved wholesale power prices and more sales activity at our telecommunications business. Increased sales of nonregulated generation resulted from Taconite Harbor being available for a full 12 months in 2003. Taconite Harbor generation first came online at various times during the first half of 2002.

Operating expenses in total were up $30.1 million, or 5%, in 2003. Regulated utility operating expenses were up $26.3 million, or 6%, in 2003 primarily due to increased purchased power and gas expense, as well as increased employee pension and benefit expenses. Higher purchased power costs resulted from both increased wholesale prices and quantities purchased. Planned maintenance outages at our generating stations and lower output from our hydro facilities as a result of drier weather necessitated higher quantities of purchased power this year. Gas expense was higher in 2003 due to increased prices. Expenses for pension and post-retirement health benefits increased mainly due to lower discount rates and expected rates of return on plan assets. Operating expenses in 2002 included a $4 million one-time deferral of costs recoverable through the utility fuel clause. Nonregulated operating expenses increased $3.8 million, or 3%, over the prior year mainly due to fuel and purchased power expenses for nonregulated generation that came online during the first half of 2002. Purchased power expense in 2003 included a full 12 months of demand charges related to the Kendall County power purchase agreement, while 2002 included only eight months. Operating expenses were also higher in 2003 due to increased sales activity at our telecommunications business. Operating expenses in 2002 included a $9.5 million charge related to the indefinite delay of the generation project in Superior, Wisconsin.

Automotive Services

Operating revenue was up $86.5 million, or 10%, in 2003. Revenue from our auction and related services was higher in 2003 primarily due to an increased number of vehicles sold through our auctions, a shift towards the sale of more institutional vehicles, selective fee increases and the increased Canadian dollar currency exchange rate. At our used vehicle auction facilities, 4% more vehicles were sold in 2003. Most of the auction volume growth consisted of internal same store growth. Volumes increased in 2003 due to the stabilization of wholesale used vehicle prices in mid-2003, increased demand for used vehicles as retail demand increased during the year and an increase in volume from our institutional customers. At our salvage auction facilities, vehicles sold increased 9% as we expanded into new markets, including sites where we combined salvage auctions with our existing used vehicle auction facilities. Same store vehicles sold at our salvage auctions increased slightly less than 1%.

While the number of loan transactions by AFC was up slightly from last year, revenue from AFC was up in 2003 primarily because strong receivable portfolio management lowered bad debt expense. As customary for a finance company, we report revenue net of interest expense and bad debt expense.

Operating expenses were up $51.0 million, or 7%, in 2003 primarily due to additional expenses incurred for reconditioning and logistics services as a result of a shift towards the sale of more institutional vehicles at our auctions, increased Canadian dollar currency exchange rate, and costs incurred due to inclement weather and general inflationary increases.

Investments and Corporate Charges

Operating revenue was up $4.4 million, or 14%, in 2003 as more real estate sales offset less revenue from our emerging technology investments. In 2003, 11 large real estate sales contributed $18.5 million to revenue compared to 2002 when five large real estate sales contributed $8.5 million to revenue. In 2003 we recognized a $3.5 million loss related to the sale of shares the Company held directly in publicly-traded emerging technology investments, while in 2002 we recognized a $3.3 million gain on the sale of certain emerging technology investments. Revenue in 2002 also included losses on our trading securities portfolio which was liquidated during the second half of 2002.

Operating expenses were down $0.5 million, or 1%, in 2003 in part due to lower expenses related to our real estate operations because the cost of property sold in 2003 was lower than in 2002.

Corporate Charges included operating and other expense totaling $17.6 million in 2003 ($16.5 million in 2002) for general corporate expenses such as employee salaries and benefits, and legal and other outside contract service fees, and interest expense of $28.0 million in 2003 ($28.1 million in 2002).

2002 Compared to 2001

Energy Services

Operating revenue in total was up $7.3 million, or 1%, in 2002 as increased revenue from nonregulated operations was partially offset by a decrease in regulated utility revenue. Despite a slight increase in regulated utility megawatthour sales, regulated utility revenue decreased $33.1 million, or 6%, due to lower wholesale prices and fuel clause recoveries. Fuel clause recoveries in 2002 were lower due to lower purchased power costs in 2002. Total regulated utility megawatthour sales were up 2% over the prior year reflecting increased retail sales to taconite customers. In addition, regulated utility revenue in 2001 included the recovery of $4.5 million for 1998 CIP lost margins. Nonregulated revenue increased $40.4 million, or 51%, in 2002 primarily as a result of about 500 MW of nonregulated generation that came online in 2002. There were 1.2 million megawatthours of nonregulated generation sold in 2002.

Operating expenses in total increased $25.9 million, or 5%, in 2002. The increase was attributable to additional expenses for nonregulated generation that came online in 2002 which were partially offset by lower regulated utility operating expenses. Regulated utility operating expenses were down $33.3 million, or 7%, in 2002 primarily due to lower purchased power costs. Lower purchased power costs resulted from both lower wholesale prices and a reduction in the quantity of power purchased. Extended planned maintenance outages in 2001 necessitated higher quantities of purchased power. Nonregulated operating expenses increased $59.2 million, or 77%, over the prior year mainly due to expenses for nonregulated generation that came online in 2002. The increase in nonregulated operating expenses also included the $9.5 million charge related to the indefinite delay of the generation project in Superior, Wisconsin.

Automotive Services

Operating revenue was up $3.7 million, or less than 1%, in 2002. At ADESA used vehicle auction facilities, the number of vehicles sold in 2002 was similar to 2001 because the rental car market had yet to restore vehicle fleets to levels prior to the events of September 11, 2001, and manufacturer incentives on new vehicles temporarily disrupted the price spreads between new and used vehicles.

Despite unseasonably dry weather conditions in 2002 which usually means fewer salvage vehicles, vehicles sold at our salvage vehicle auction facilities were up 18% reflecting expansion into new markets, which included adding salvage auctions at some of our used vehicle auction facilities. Operating revenue from AFC was up in 2002 due to a 5% increase in loan transactions arranged through our loan production offices and lower bad debt expense as a result of strong portfolio management.

Operating expenses were down $31.4 million, or 4%, in 2002 due to reduced interest expense ($14.1 million) as a result of lower interest rates and a lower debt balance, the discontinuance of goodwill amortization ($12.5 million) and improved operating efficiencies. These decreases were partially offset by an increase in operating expenses incurred to standardize operations at all of our salvage vehicle auction facilities and expenditures for information technology initiatives.

Investments and Corporate Charges

Operating revenue was down $42.3 million, or 57%, in 2002 primarily due to a large real estate transaction recorded in 2001. Five large real estate sales in 2002 contributed $8.5 million to revenue, while in 2001 six large real estate sales contributed $37.5 million to revenue, one of which was our real estate operations' largest single transaction ever. Operating revenue in 2002 also reflected less income from our trading securities portfolio which was substantially liquidated during the second half of the year and had significantly lower returns during the year.

Operating expenses were down $14.7 million, or 19%, in 2002 because of expenses associated with larger real estate sales in 2001. Also, in 2001 additional compensation expenses were incurred for severance packages.

Corporate Charges included operating and other expense totaling $16.5 million in 2002 ($22.8 million in 2001) for general corporate expenses such as employee salaries and benefits, and legal and other outside contract service fees, and interest expense of $28.1 million in 2002 ($25.2 million in 2001).

Critical Accounting Policies

Certain accounting measurements under applicable generally accepted accounting principles involve management's judgment about subjective factors and estimates, the effects of which are inherently uncertain. These policies are reviewed with the audit committee of our Board of Directors on a regular basis. The following summarizes those accounting measurements we believe are most critical to our reported results of operations and financial condition.

Uncollectible Receivables and Allowance for Doubtful Accounts. The allowance for doubtful accounts and related bad debt expense is primarily attributable to the financing activities of AFC. In establishing a proper allowance for doubtful accounts, our quarterly evaluation includes consideration of historical charge-off experience, current economic conditions and specific collection issues. Changes to historical charge-off experience or existing economic conditions would necessitate a corresponding increase or decrease in the allowance for doubtful accounts. The credit quality of AFC's finance

receivable portfolio has remained strong and the total amount of the allowance for doubtful accounts has not changed materially over the last three years. A 10% increase in AFC's current allowance for doubtful accounts would increase bad debt expense by approximately $1 million after tax; likewise, a 10% decrease in the current allowance for doubtful accounts would decrease bad debt expense by approximately $1 million after tax.

Impairment of Goodwill and Long-Lived Assets. We annually review our assets for impairment. SFAS 142, "Goodwill and Other Intangible Assets" and SFAS 144, "Accounting for the Impairment and Disposal of Long-Lived Assets" are the basis for these analyses. Judgments and uncertainties affecting the application of accounting for asset impairment include: economic conditions affecting market valuations; changes in our business strategy; and changes in our forecast of future operating cash flows and earnings.

We conduct our annual goodwill impairment testing in the second quarter of each year and the 2003 test resulted in no impairment. No event or change has occurred that would indicate the carrying amount has been impaired since our annual test. All goodwill relates to the Automotive Services segment and represents the excess of cost over identifiable tangible and intangible net assets of businesses acquired.

We account for our long-lived assets at depreciated historical cost. A long-lived asset is tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. We would recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows. Management judgment is involved in both deciding if testing for recoverability is necessary and in estimating undiscounted cash flows. Excluding impairment losses recorded on certain remaining water assets held for sale, as of December 31, 2003 no write-downs were required.

Pension and Postretirement Health and Life Actuarial Assumptions. We account for our pension and postretirement benefit obligations in accordance with the provisions of SFAS 87, "Employers' Accounting for Pensions" and SFAS 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions." These standards require the use of assumptions in determining the obligations and annual cost. An important actuarial assumption for pension and other postretirement benefit plans is the expected long-term rate of return on plan assets. In establishing this assumption, we consider the diversification and allocation of plan assets, the actual long-term historical performance for the type of securities invested in, the actual long-term historical performance of plan assets and the impact of current economic conditions, if any, on long-term historical returns. Our pension asset allocation is approximately 70% equity and 30% fixed-rate securities. Equity securities consist of a mix of market capitalization sizes and also include investments in real estate and venture capital. In response to changing market conditions, we have lowered our actuarial assumption for the expected long-term rate of return and used 9% in the September 30, 2003 pension actuarial study (9.5% at September 30, 2002; 10% at September 30, 2001). We annually review our expected long-term rate of return assumption, and will continue to adjust it to respond to any changing market conditions. A 1/2% decrease in the expected long-term rate of return would increase the annual expense for pension and other postretirement benefits by approximately $1 million after tax; likewise, a 1/2% increase in the expected long-term rate of return would decrease the annual expense by approximately $1 million after tax.

Valuation of Investments. As part of our emerging technology portfolio, we have several minority investments in venture capital funds and privately-held start-up companies. These investments are accounted for using the cost method and included with Investments on our consolidated balance sheet. Our policy is to quarterly review these investments for impairment by assessing such factors as continued commercial viability of products, cash flow and earnings. Any impairment would reduce the carrying value of the investment and be recognized as a loss. We did not record any impairment loss on these investments in 2003 ($1.5 million pretax in 2002; $0.2 million pretax in 2001).

Provision for Environmental Remediation. Our businesses are subject to regulation by various U.S. and Canadian federal, state and local authorities concerning environmental matters. 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. These accruals are adjusted periodically as assessment and remediation efforts progress, or as additional technical or legal information become available. Accruals for environmental liabilities are included in the balance sheet at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. Costs related to environmental contamination treatment and cleanup are charged to expense. We do not currently anticipate that potential expenditures for environmental matters will be material; however, if we become subject to more stringent remediation at known sites, if we discover additional contamination, or discover previously unknown sites, or become subject to related personal or property damage, we could incur material costs in connection with our environmental remediation.

Outlook

Our operations in 42 states, nine Canadian provinces and Mexico employ approximately 13,000 employees. Since 1980 our average annual total shareholder return is 17%. Approximately 44% of this average was attributed to dividends. A $100 investment in ALLETE stock at the end of 1980 would have been worth $3,800 at the end of 2003, assuming reinvestment of dividends on the ex-dividend date. By comparison, the Standard & Poor's 500 Index averaged

13% for the same period, of which approximately 24% of the average was attributed to dividends. A $100 investment in the Standard & Poor's 500 Index at the end of 1980 would have been worth $1,600 at the end of 2003, assuming reinvestment of dividends on the ex-dividend date.

We remain focused on continuously improving the performance of our two core businesses, Energy and Automotive Services.

As part of a strategic initiative to exit our Water Services businesses, during 2003 we sold, under condemnation or imminent threat of condemnation, substantially all of our water assets in Florida for a total sales price of approximately $445 million. In addition, we reached an agreement to sell our North Carolina water assets for $48 million and the assumption of approximately $28 million in debt by the purchaser. The North Carolina sale is awaiting approval of the NCUC and is expected to close in mid-2004. We expect to sell our remaining water assets in 2004.

Our two core businesses remain strong and are poised for growth in their respective markets.

Spin-Off of Automotive Services. In October 2003 our Board of Directors approved a plan to spin off to ALLETE shareholders our Automotive Services business which will become a publicly traded company doing business as ADESA. The spin-off, anticipated to occur in the third quarter of 2004, is expected to take the form of a tax-free stock dividend to ALLETE's shareholders, who would receive one ADESA share for each share of ALLETE stock they own. The spin-off is subject to the approval of the final plan by ALLETE's Board of Directors, favorable market conditions, receipt of tax opinions, satisfaction of SEC requirements and other customary conditions.

In March 2004 our Board of Directors approved an initial public offering (IPO) of approximately $150 million in common shares of ADESA, representing less than 20% of all ADESA common stock outstanding. A registration statement was filed with the SEC in March 2004, with the sale of ADESA stock expected to take place as soon as practical after the registration statement becomes effective. Subsequent to the IPO, ALLETE will continue to own and consolidate the remaining portion of ADESA until consummation of the spin-off.

Our Energy Services and Automotive Services businesses are two very distinct businesses and we believe that this spin-off will better facilitate the strategic objectives of both businesses. We believe that our Automotive Services business will be better able to pursue a business growth strategy as an independent company. For ALLETE, we believe the spin-off will create a simplified regulatory and risk profile and a more stable credit rating, which will enhance its ability to pursue strategic growth initiatives.

Our Automotive Services business operates two main businesses that are integral parts of the vehicle redistribution industry in North America. Auctions and related services include 53 used vehicle auctions, 27 salvage vehicle auctions and other related services, while dealer financing consists of AFC's 80 loan production offices. Our Automotive Services business will remain based in Indiana.

After the spin-off, ALLETE will be comprised of our Energy Services business, which includes Minnesota Power, SWL&P, BNI Coal, Enventis Telecom and Rainy River Energy, ALLETE Properties, Inc., our real estate operations in Florida, and our emerging technology investments. ALLETE's headquarters will remain in Duluth, Minnesota.

ALLETE has a history of growing our nonregulated asset and earnings base through careful analysis by our experienced management team. Near term we will focus on growth opportunities in our existing business segments and on improving both operational and financial performance. Longer term our strategy is to expand into businesses or investments that meet our free cash flow and return on investment criteria. We will continue to capitalize on our experienced management team in finding businesses that ultimately enable ALLETE to provide superior total shareholder returns.

Prior to the spin-off, ALLETE and ADESA will enter into recapitalization and debt reallocation transactions. As part of this recapitalization, ADESA will use a portion of the proceeds from the IPO and additional debt issuances to pay a $100 million dividend to ALLETE, as well as repay intercompany debt ($136 million at December 31, 2003). ALLETE expects to use the funds received from ADESA to reduce debt by approximately $150 million to $200 million, provide capital for strategic initiatives and for general corporate purposes. ADESA expects to use the remaining proceeds from the IPO and additional debt issuances to repay existing debt and repurchase ADESA common stock from certain ALLETE employee benefit plans upon consummation of the spin-off. Immediately following the spin-off, we expect ALLETE's debt to capital ratio to be approximately 40%.

The amount and timing of future dividends on ALLETE common stock and ADESA common stock following the spin-off is subject to the sole discretion of each company's Board of Directors in light of all relevant facts, including earnings, general business conditions and working capital requirements. ALLETE's Board of Directors expects to continue quarterly dividend payments at the current rate until the time of the spin-off. At that time, ALLETE's Board of Directors anticipates it will adjust the dividend rate to equal a payout ratio similar to that of comparable companies.

Subsequent to the spin-off of ADESA, our Retirement Savings and Stock Ownership Plan, or RSOP, (see Note 19) will have a significant amount of cash generated from the sale of ADESA stock received in the spin-off. The RSOP intends to use this cash to purchase ALLETE common stock, and federal income tax laws generally provide up to 90 days to complete this purchase. To facilitate the RSOP's purchase of ALLETE stock, we have sought Internal Revenue Service (IRS) approval to extend the purchase period to approximately 600 days. We expect the IRS to rule on our request later this year.

In connection with the IPO of ADESA common stock and the subsequent spin-off of ADESA to ALLETE shareholders, ALLETE and ADESA have entered into various separation agreements and indemnifications customary to a transaction of this nature.

Energy Services. In 2004 net income from Energy Services will be negatively impacted by higher pension and postretirement health expenses, and additional expenses associated with planned maintenance at Square Butte. Pension and postretirement health expenses are expected to be approximately $7 million pretax higher than 2003, primarily due to a lower discount rate and expected long-term return on plan assets. (See Note 18.) In 2004 Square Butte will perform a planned multi-week maintenance outage, and we expect our pro rata share of the cost to be approximately $6 million pretax.

In February 2004 we experienced a generator failure at our 534-MW Boswell Energy Center Unit 4. As a result of the failure we expect to have to replace significant components of the generator at an estimated capital cost of $5 million. The majority of the replacement cost is covered by insurance, subject to a deductible of $1 million. We have entered into power purchase agreements to replace the power lost during the Unit 4 outage, which is expected to continue through May 2004. The cost of this additional power will be recovered through the regulated utility fuel clause. We do not expect this outage to have a material impact on our results of operations.

Over the next five years, we believe electric utilities will face three major issues: the ongoing changes in regional transmission structure, the probable enactment of stricter environmental regulations and possible federal legislation impacting the structure and organization of the electric utility industry. The FERC plans to consolidate transmission regions, which may impact states' transmission regulation rights and create a more standard market design to oversee how transmission prices are determined. Specifics are being debated by legislative and regulatory bodies. Stricter environmental requirements may require significant capital investments in the 2008 to 2012 timeframe. The expenditures will relate to new emission controls on existing generating units. Proposed rules defining requirements are expected to be finalized over the next one to four years. Though stalled in 2003, a revised federal energy bill could pass in 2004. More electric industry consolidation could occur and new players could enter the industry if the Public Utility Holding Company Act of 1935 is repealed as part of this legislation. This act imposes geographic restrictions on large electric and gas utility operations and limits diversification into nonutility businesses.

We believe our Energy Services business is well positioned to successfully deal with these issues and to successfully compete. Our access to and ownership of low-cost power are Energy Services' greatest strengths. We have adequate generation to serve our native load. Power over and above our customers' requirements will be marketed. We also have adequate transmission capacity. We believe electric industry deregulation is unlikely in Minnesota or Wisconsin in the next five years. We anticipate any load losses will be manageable and that we will have ready access to sufficient capital for general business purposes.

Approximately 50% of our regulated utility electric sales are made to taconite mines, paper producers and oil pipeline operators. Global economic conditions continue to affect our largest industrial retail customers and are likely to continue over the next few years, as consolidation in the steel and taconite industries continues, and while paper and pulp companies search for even more efficiency and cost-cutting measures to compete in the marketplace. A rise in Chinese steel demand and production has created a new market for the producers of taconite in North America. Based on our research of the taconite industry, Minnesota taconite production for 2004 is anticipated to be about 39 million tons. The annual taconite production in Minnesota was 34 million tons in 2003 (39 million tons in 2002; 33 million tons in 2001).

Though changes may occur with some of our large industrial customers, the taconite industry is stable at this time. Our strong relationships with industrial customers are unique in the electric industry and enable us to work closely with them to help ensure their success. We continue strengthening these relationships to retain a strong industrial base in our region. On average we expect approximately 1% growth in retail electric kilowatthour sales annually over the next five years. We continue to make investments to maintain and improve the integrity of our generating, transmission and distribution assets, and maintain environmental compliance. Minnesota Power is in the early stages of preparing a request to the MPUC to increase rates for its Minnesota electric utility operations sometime in the first half of 2005. The request may be necessary to cover the increased cost of doing business. Minnesota Power's last rate increase for its electric utility operations was in 1994. SWL&P is preparing to file with the PSCW in mid-2004 a request to increase retail rates for its Wisconsin electric utility operations to be effective sometime in early 2005. The request would cover increases in the cost of doing business. SWL&P's last rate order for its electric utility operations was in 2001.

In June 2003 the MPUC initiated an investigation into the continuing usefulness of the fuel clause as a regulatory tool for electric utilities. The investigation will focus on whether the fuel clause continues to be an appropriate regulatory tool. The initial steps will be to review the clause's original purpose, structure and rationale (including its current operation and relevance in today's regulatory environment), and then address its ongoing appropriateness and other issues if the need for continued use of the fuel adjustment clause is shown. Because this investigation is in its early stages, we are unable to predict the outcome or impact, if any, at this time.

In response to the changing strategies of both parties, as of February 2004 we withdrew from active participation in Split Rock Energy and will terminate our ownership interest upon receipt of FERC approval which is expected in the first half of 2004. We have reestablished our least-cost supply and marketing functions within the Company.

Alternatives are being explored to reduce the negative earnings impact of the Kendall County power contract.

Our strategy is to solidify our existing customer base and seek regulated utility growth opportunities by: (1) being an advocate

in our region for additional industrial customers to build or expand thus adding new customer load growth; (2) using our existing assets and enhancing them to develop new opportunities to primarily serve retail customers; and (3) evaluating and developing Large Power Customer projects. We will also seek to increase our presence as a supplier to regional utilities by looking for nonregulated generation opportunities, joint ownership of newly constructed generation, and promoting our capabilities as a regional capacity and energy supplier to meet increasing regional load requirements.

Automotive Services is pursuing strategic initiatives that are designed to capitalize on its underlying business strengths, grow its business and improve its profitability.

We seek continuing growth through various channels, including alternate auction venues, combination used and salvage vehicle auction sites, acquisitions of independent auctions, and greenfield development of new auctions. In areas where we have existing operations, we seek to leverage upon existing infrastructure and capital investments in used vehicle operations by opening new salvage auction sites. Our auction sites in Jacksonville, Concord, Buffalo, Edmonton, Vancouver, Halifax and Ottawa are shared facilities that have successfully executed this strategy. We will continue to examine our existing sites for opportunities to combine used vehicle and salvage auction operations.

We have been a consolidator in used vehicle auctions, which has fueled much of our historical growth. We continue to consider acquiring independent used vehicle auctions in markets where we do not have a presence. We also expect that consolidation opportunities will be available for salvage auctions. In regions where we do not have a presence or where we are not able to identify acquisition sites or we do have a presence but our auction sites are inadequate or at capacity, we will consider greenfield development or relocation of auction sites. We have successfully demonstrated this strategy in recent years in the following markets: Los Angeles, Boston, Des Moines, Colorado Springs, San Francisco, Vancouver, Long Island, Atlanta and Edmonton. We also opened new salvage auction sites in Orlando and Long Island separate from our used vehicle operations in those markets. We may not, however, adequately anticipate all of the demands that our growth will impose on our systems, procedures and structures, including our financial and reporting control systems, data processing systems and management structure.

We strive to capitalize on the growing pool of redistributed vehicles and to increase the volume of used and salvage vehicles redistributed through our auctions. Our initiatives include expanding marketing of our services, such as selling additional reconditioning services and offering post-sale inspections and certifications. We intend to increase the volume of vehicles sold by our existing institutional customers and add to new accounts by enabling customers to maximize the value of their vehicles through the redistribution process. We believe we can continue to expand our market share by realizing the highest prices for our customers' vehicles and providing the best service.

We plan to increase revenue by selling more services per vehicle, such as reconditioning, inspection, certification, titling and settlement administration services. We believe we can significantly increase service penetration among both sellers and buyers due to the economic benefits that our pre- and post-auction services provide.

We are improving our operating efficiency by further centralizing certain administrative functions, optimizing and standardizing our redistribution processes, improving our use of technology and better utilizing our existing infrastructure. Current initiatives aim at providing better information throughout the auction process and moving vehicles faster, more accurately and more efficiently through the auction process.

We plan to continue to expand our existing on-line service offerings in addition to introducing new on-line services to our customers. Direct sales of used vehicles by institutional customers and large dealer groups through internally developed or third party on-line auctions have largely replaced telephonic and other non-auction methods, becoming an increasing portion of overall used vehicle redistribution over the past several years. In addition, a portion of the vehicles that were sold through a physical auction are now being sold on-line. Although we have embraced the Internet and offer on-line auctions and services as part of our standard service offerings, we cannot predict what portion of overall sales will be conducted through on-line auctions or other redistribution methods in the future and what impact this may have on our auction facilities.

We are committed to investing additional capital and resources for emerging technologies and service offerings in the vehicle redistribution industry. We will continue to tailor on-line services to each of our customers to include an appropriate mix of physical auctions and on-line services.

Investments and Corporate Charges. In 2004, excluding the financial implications of the spin-off of Automotive Services, we expect net income from Investments and Corporate Charges to be approximately $5 million to $10 million higher primarily as a result of debt paid off in 2003 with proceeds from the sale of our Water Services businesses and internally generated cash. The financial implications of the spin-off of Automotive Services include one-time expenses of the transaction for advisor fees, debt retirement premiums and the impact of cash received from ADESA after the IPO.

Revenue from property sales by real estate operations continues to be three to four times more than the acquisition cost, creating strong cash generation and profitability. Our real estate operations may, from time to time, acquire packages of diversified properties at low cost, add value through entitlements and infrastructure enhancements, and sell the properties at current market prices.

We have the potential to recognize gains or losses on the sale of investments in our emerging technology portfolio. We plan to sell investments in our emerging technology portfolio as shares are distributed to us. Some restrictions on sales may apply, including, but not limited to, underwriter lock-up

periods that typically extend for 180 days following an initial public offering. We have committed to make additional investments in certain emerging technology holdings. The total future commitment was $4.8 million at December 31, 2003 and is expected to be invested at various times through 2007.

Liquidity and Capital Resources

Cash Flow Activities

A primary goal of our strategic plan is to improve cash flow from operations. Our strategy includes growing the businesses both internally by expanding facilities, services and operations (see Capital Requirements), and externally through acquisitions.

During 2003 cash flow from operating activities reflected strong operating results and continued focus on working capital management. Cash flow from operating activities was higher in 2002 due to the liquidation of the trading securities portfolio and the timing of the collection of certain finance receivables outstanding at December 31, 2001. Cash flow from operations was also affected by a number of factors representative of normal operations.

Using both the proceeds from the sale of Water Services and internally generated cash, we repaid $360 million in debt and $75 million in manditorily redeemable preferred securities during 2003. By year end, we significantly strengthened our balance sheet and reduced our debt to total capital percentage to 36% (46% at December 31, 2002), while at the same time improving our current ratio to 1.3 (0.9 at December 31, 2002).

Working Capital. Additional working capital, if and when needed, generally is provided by the sale of commercial paper. During 2002 we liquidated our trading securities portfolio and used the proceeds to reduce our short-term debt. Approximately 3.8 million original issue shares of our common stock are available for issuance through *Invest Direct*, our direct stock purchase and dividend reinvestment plan. We have bank lines of credit aggregating $196.5 million, the majority of which expire in December 2004 and are negotiated on an annual basis. These bank lines of credit provide credit support for our commercial paper program. The amount and timing of future sales of our securities will depend upon market conditions and our specific needs. We may sell securities to meet capital requirements, to provide for the retirement or early redemption of issues of long-term debt, to reduce short-term debt and for other corporate purposes.

A substantial amount of ADESA's working capital is generated internally from payments for services provided. ADESA, however, has arrangements to use proceeds from the sale of commercial paper issued by ALLETE to meet short-term working capital requirements arising from the timing of payment obligations to vehicle sellers and the availability of funds from vehicle purchasers. During the sales process, ADESA does not generally take title to or ownership of the vehicles consigned for auction but instead facilitate the transfer of vehicle ownership directly from sellers to buyers.

AFC offers floorplan financing for dealers to purchase vehicles mostly at auctions and takes a security interest in each financed vehicle. The financing is provided through the earlier of the date the dealer sells the vehicle or a general borrowing term of 30 to 45 days. AFC has arrangements to use proceeds from the sale of commercial paper issued by ALLETE to meet its short-term working capital requirements not funded through securitization.

Sale of Water Plant Assets. During 2003 we sold, under condemnation or imminent threat of condemnation, substantially all of our water assets in Florida for a total sales price of approximately $445 million. In addition, we reached an agreement to sell our North Carolina water assets for $48 million and the assumption of approximately $28 million in debt by the purchaser. The North Carolina sale is awaiting approval of the NCUC and is expected to close in mid-2004. We expect to sell our remaining water assets in 2004.

Earnings from Discontinued Operations for 2003 included a $71.6 million after-tax gain on the sale of substantially all our Water Services businesses. The gain was net of all selling, transaction and employee termination benefit expenses, as well as impairment losses on certain remaining assets.

The net cash proceeds from the sale of all water assets, after transaction costs, retirement of most Florida Water debt and payment of income taxes, are expected to be approximately $300 million. These net proceeds have been, and will be, used to retire debt at ALLETE.

Off-Balance Sheet Arrangements

AFC sells the majority of U.S. dollar denominated finance receivables on a revolving basis to a wholly owned, bankruptcy remote, special purpose subsidiary that is consolidated for accounting purposes. The special purpose subsidiary has entered into a securitization agreement, which expires in 2005, that allows for the revolving sale to a bank conduit facility of up to a maximum of $500 million in undivided interests in eligible finance receivables. Receivables sold are not reported on our consolidated financial statements.

At December 31, 2003 AFC managed total finance receivables of $539 million ($501 million at December 31, 2002), of which $464 million had been sold to the special purpose subsidiary ($423 million at December 31, 2002). The special purpose subsidiary then in turn sold, with recourse to the special purpose subsidiary, $334 million to the bank conduit facility at December 31, 2003 ($304 million at December 31, 2002) leaving $205 million of finance receivables recorded on our consolidated balance sheet at December 31, 2003 ($197 million at December 31, 2002).

AFC's proceeds from the revolving sale of receivables to the bank conduit facility were used to repay borrowings from ALLETE and fund new loans to customers. AFC and the special purpose subsidiary must maintain certain financial covenants such as minimum tangible net worth to comply with the terms of the securitization agreement. AFC has historically performed better than the covenant thresholds set

forth in the securitization agreement, and we are not aware of any changing circumstances that would put AFC in noncompliance with the covenants.

Securities

In March 2001 ALLETE, ALLETE Capital II and ALLETE Capital III, jointly filed a registration statement with the SEC pursuant to Rule 415 under the Securities Act of 1933. The registration statement, which has been declared effective by the SEC, relates to the possible issuance of a remaining aggregate amount of $387 million of securities which may include ALLETE common stock, first mortgage bonds and other debt securities, and ALLETE Capital II and ALLETE Capital III preferred trust securities. ALLETE also previously filed a registration statement, which has been declared effective by the SEC, relating to the possible issuance of $25 million of first mortgage bonds and other debt securities. We may sell all or a portion of the remaining registered securities if warranted by market conditions and our capital requirements. Any offer and sale of the above mentioned securities will be made only by means of a prospectus meeting the requirements of the Securities Act of 1933 and the rules and regulations thereunder.

In June 2003 ADESA restructured its financial arrangements with respect to its used vehicle auction facilities located in Tracy, California; Boston, Massachusetts; Charlotte, North Carolina; and Knoxville, Tennessee. These used vehicle auction facilities were previously accounted for as operating leases. The transactions included the assumption of $28 million of long-term debt, the issuance of $45 million of long-term debt and the recognition of $73 million of property, plant and equipment. The $28 million of assumed long-term debt matures April 1, 2020 and has a variable interest rate equal to the seven-day AA Financial Commercial Paper Rate plus approximately 1.2%, while the $45 million of long-term debt issued to finance the used vehicle auction facility in Tracy, California, matures July 30, 2006 and has a variable interest rate of prime or LIBOR plus 1%.

In July 2003 ALLETE used internally generated funds to retire $25 million in principal amount of the Company's First Mortgage Bonds, Series 6 1/4% due July 1, 2003.

In July 2003 ALLETE entered into a credit agreement to borrow $250 million from a consortium of financial institutions, the proceeds of which were used to redeem $250 million in principal amount of the Company's Floating Rate First Mortgage Bonds due October 20, 2003. The credit agreement expires in July 2004, has an interest rate of LIBOR plus 0.875% and is secured by the lien of the Company's Mortgage and Deed of Trust. The credit agreement also has certain mandatory prepayment provisions, including a requirement to repay an amount equal to 75% of the net proceeds from the sale of water assets. In accordance with these provisions, $197.0 million was repaid in 2003 and $53.0 million was outstanding at December 31, 2003.

In November 2003 ALLETE redeemed $50 million in principal amount of the Company's First Mortgage Bonds, 7 3/4% Series due June 1, 2007. Internally generated funds and proceeds from the sale of Florida Water assets were used to repay the principal, premium and accrued interest, totaling approximately $52.1 million, to the bondholders.

In December 2003 ALLETE redeemed through ALLETE Capital I, a wholly owned statutory trust of ALLETE, all $75 million aggregate liquidation amount of its 8.05% Cumulative Quarterly Income Preferred Securities (QUIPS). The redemption price was $25 per QUIPS plus accumulated and unpaid distributions to the redemption date. Proceeds from the sale of Florida Water assets were used to fund this redemption.

In January 2004 we used internally generated funds to retire approximately $3.5 million in principal amount of Industrial Development Revenue Bonds Series 1994-A, due January 1, 2004.

ALLETE's long-term debt arrangements contain financial covenants. The most restrictive covenant requires ALLETE not to exceed a maximum ratio of funded debt to total capital of .65 to 1.0. Failure to meet this covenant could give rise to an event of default, if not corrected after notice from the trustee or security holder; in which event ALLETE may need to pursue alternative sources of funding. As of December 31, 2003 ALLETE's ratio of funded debt to total capital was .36 to 1.0 and ALLETE was in compliance with its financial covenants.

Some of ALLETE's long-term debt arrangements contain "cross-default" provisions that would result in an event of default if there is a failure under other financing arrangements to meet payment terms or to observe other covenants that would result in an acceleration of payments due.

Our lines of credit contain financial covenants. These covenants require ALLETE (1) not to exceed a maximum ratio of funded debt to total capital of .60 to 1.0 and (2) to maintain an interest coverage ratio of not less than 3.00 to 1.00. Failure to meet these covenants could give rise to an event of default, if not corrected after notice from the lender; in which event ALLETE may need to pursue alternative sources of funding. As of December 31, 2003 ALLETE's ratio of funded debt to total capital was .36 to 1.0, the interest coverage ratio was 5.83 to 1.00 and ALLETE was in compliance with these financial covenants.

ALLETE's lines of credit contain cross-default provisions, under which an event of default would arise if other ALLETE obligations in excess of $5.0 million were in default.

Contractual Obligations and Commercial Commitments

Our long-term debt obligations, including long-term debt due within one year, represent the principal amount of bonds, notes and loans which are recorded on our consolidated balance sheet plus interest.

Unconditional purchase obligations represent our Square Butte and Kendall County power purchase agreements, and minimum purchase commitments under coal and rail contracts.

Under our power purchase agreement with Square Butte that extends through 2026, we are obligated to pay our pro rata share of Square Butte's costs based on our entitlement to the output of Square Butte's 455 MW coal-fired generating unit near Center, North Dakota. Our payment obligation is

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 Year	1 to 3 Years	4 to 5 Years	After 5 Years
Millions					
Long-Term Debt	$1,142.3	$ 84.6	$414.2	$211.1	$432.4
Operating Lease Obligations	104.4	14.8	25.0	10.7	53.9
Unconditional Purchase Obligations	550.7	22.9	68.8	45.9	413.1
	$1,797.4	$122.3	$508.0	$267.7	$899.4

suspended if Square Butte fails to deliver any power, whether produced or purchased, for a period of one year. Square Butte's fixed costs consist primarily of debt service. The table above reflects our share of future debt service based on our current output entitlement of 71% through 2005 and 66% thereafter. In December 2003 we received notice from Minnkota Power that they will reduce our output entitlement, effective January 1, 2006, by 5% to approximately 66%. Minnkota Power has the option to reduce our entitlement by 5% annually, to a minimum of 50%. (See Note 15.)

Under the Kendall County agreement, we pay a fixed capacity charge for the right, but not the obligation, to utilize one 275 MW generating unit near Chicago, Illinois. We are responsible for arranging the natural gas fuel supply and are entitled to the electricity produced. (See Note 15.)

Emerging Technology Investments. We have investments in emerging technologies through the minority investments in venture capital funds and privately-held start-up companies. We have committed to make additional investments in certain emerging technology holdings. The total future commitment was $4.8 million at December 31, 2003 ($7.7 million at December 31, 2002) and is expected to be invested at various times through 2007.

Credit Ratings

Our securities have been rated by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. (Standard & Poor's) and by Moody's Investors Service, Inc. (Moody's). In October 2003, following our announcement that we will implement a major corporate restructuring that will separate our two core businesses, Standard & Poor's reaffirmed that our BBB+ corporate credit rating remains on CreditWatch with developing implications. Our BBB+ corporate credit rating has been on *CreditWatch Developing* since January 2003 when we first announced that we were considering a major corporate restructuring. In an October 2003 press release Standard & Poor's stated that the *CreditWatch* listing will be resolved in the very near future and is likely to result in no change to ALLETE's ratings.

Rating agencies use both quantitative and qualitative measures in determining a company's credit rating. These measures include business risk, liquidity risk, competitive position, capital mix, financial condition, predictability of cash flows, management strength and future direction. Some of the quantitative measures can be analyzed through a few key financial ratios, while the qualitative ones are more subjective. The disclosure of these credit ratings is not a recommendation to buy, sell or hold our securities. Ratings are subject to revision or withdrawal at any time by the assigning rating organization. Each rating should be evaluated independently of any other rating.

Credit Ratings	Standard & Poor's	Moody's
Issuer Credit Rating	BBB+	Baa2
Commercial Paper	A-2	P-2
Senior Secured		
First Mortgage Bonds	A	Baa1
Pollution Control Bonds	A	Baa1
Senior Unsecured		
Senior Notes	BBB	Baa2
Unsecured Debt	BBB	Baa2

Payout Ratio

In 2003 we paid out 40% (66% in 2002; 59% in 2001) of our per share earnings in dividends.

Capital Requirements

Consolidated capital expenditures totaled $136.3 million in 2003 ($201.2 million in 2002; $149.2 million in 2001). Expenditures for 2003 included $73.6 million for Energy Services and $26.9 million for Automotive Services. Expenditures for 2003 also included $35.8 million to maintain our Water Services businesses while they are in the process of being sold. An existing long-term line of credit and internally generated funds were the primary sources of funding for these expenditures. The 2003 capital expenditure amounts do not include $73 million of property, plant and equipment recognized upon the restructuring of financial arrangements with respect to four of our used vehicle auction facilities previously accounted for as operating leases.

Capital expenditures are expected to be $98 million in 2004 and total about $500 million for 2005 through 2008. The 2004 amount includes $63 million for Energy Services and $35 million for Automotive Services. Energy Services' expenditures are for system component replacement and upgrades, telecommunication fiber and coal handling equipment. Automotive Services' expenditures are for expansions and on-going improvements at existing vehicle auction facilities and associated computer systems. We expect to draw an additional $8 million from an existing long-term

line of credit to complete an investment in new coal handling equipment and use internally generated funds to fund all other capital expenditures.

Environmental and Other Matters

As previously mentioned in our Critical Accounting Policies section, our businesses are subject to regulation by various U.S. and Canadian federal, state, provincial and local authorities concerning environmental matters. We do not currently anticipate that potential expenditures for environmental matters will be material; however, we are unable to predict the outcome of the issues discussed below.

SWL&P Manufactured Gas Plant. In May 2001 SWL&P received notice from the WDNR that the City of Superior had found soil contamination on property adjoining a former Manufactured Gas Plant (MGP) site owned and operated by SWL&P's predecessors from 1889 to 1904. The WDNR requested SWL&P to initiate an environmental investigation. The WDNR also issued SWL&P a Responsible Party letter in February 2002. The environmental investigation is underway. In February 2003 SWL&P submitted a Phase II environmental site investigation report to the WDNR. This report identified some MGP-like chemicals that were found in the soil. During March and April 2003 sediment samples were taken from nearby Superior Bay. The report on the results of this sampling is expected to be completed and sent to the WDNR during the first quarter of 2004. A work plan for additional investigation by SWL&P was filed on December 17, 2003 with the WDNR. This part of the investigation will determine any impact to soil or ground water between the former MGP site and the Superior Bay. Although it is not possible to quantify the potential clean-up cost until the investigation is completed and a work plan is developed, a $0.5 million liability was recorded as of December 31, 2003 to address the known areas of contamination. We have recorded a corresponding dollar amount as a regulatory asset to offset this liability. The PSCW has approved SWL&P's deferral of these MGP environmental investigation and potential clean-up costs for future recovery in rates, subject to regulatory prudency review.

Minnesota Power Coal-Fired Generating Facilities. During 2002 Minnesota Power received and responded to a third request from the EPA, under Section 114 of the Clean Air Act, seeking additional information regarding capital expenditures at all of its coal-fired generating stations. This action is part of an industry-wide investigation assessing compliance with the New Source Review and the New Source Performance Standards (emissions standards that apply to new and changed units) of the Clean Air Act at electric generating stations. We have received no feedback from the EPA based on the information we submitted. There is, however, ongoing litigation involving the EPA and other electric utilities for alleged violations of these rules. It is expected that the outcome of some of the cases could provide the utility industry direction on this topic. We are unable to predict what actions, if any, may be required as a result of the EPA's request for information. As a result, we have not accrued any liability for this environmental matter.

Square Butte Generating Facility. In June 2002 Minnkota Power, the operator of Square Butte, received a Notice of Violation from the EPA regarding alleged New Source Review violations at the M.R. Young Station which includes the Square Butte generating unit. The EPA claims certain capital projects completed by Minnkota Power should have been reviewed pursuant to the New Source Review regulations potentially resulting in new air permit operating conditions. Minnkota Power has held several meetings with the EPA to discuss the alleged violations. Based on an EPA request, Minnkota Power performed a study related to the technological feasibility of installing various controls for the reduction of nitrogen oxides and sulfur dioxide emissions. Discussions with the EPA are ongoing and we are still unable to predict the outcome or cost impacts. If Square Butte is required to make significant capital expenditures to comply with EPA requirements, we expect such capital expenditures to be debt financed. Our future cost of purchased power would include our pro rata share of this additional debt service.

ADESA Impact Taunton Facility. In December 2003 the Massachusetts Department of Environmental Protection (MDEP) identified ADESA Impact as a potentially responsible party regarding contamination of several private drinking water wells in a residential development that abuts the Taunton, Massachusetts salvage vehicle auction facility. The wells had elevated levels of MTBE. MTBE is an oxygenating additive in gasoline which reduces harmful emissions. The EPA has identified MTBE as a possible carcinogen. ADESA Impact engaged GeoInsight, an environmental services firm, to conduct tests of its soil and groundwater at the salvage vehicle auction site and we are providing bottled water to some affected residents.

GeoInsight prepared an immediate response action (IRA) plan, which is required by the MDEP, to determine the extent of the environmental impact and define activities to prevent further environmental contamination. The IRA plan, which was filed on January 24, 2004, describes the initial activities ADESA Impact performed, and proposes additional measures that it will use to further assess the existence of any imminent hazard to human health. In addition, as required by the MDEP, ADESA Impact is conducting an analysis to identify sensitive receptors that may have been affected, including area schools and municipal wells. GeoInsight does not believe that an imminent hazard condition exists at the Taunton site; however, the investigation and assessment of site conditions are ongoing.

In December 2003 GeoInsight collected soil samples, conducted groundwater tests and provided oversight for the installation of monitoring wells in various locations on and adjacent to the property adjoining the residential community. The results of the soil and water tests indicated levels of MTBE exceeding MDEP standards. In January 2004 we collected air samples from two residences that we identified as

having elevated drinking water concentrations of MTBE. We have determined that inhalation of, or contact exposure to, this air poses minimal risk to human health. In response to our empirical findings, we have proposed to the MDEP that we install granular activated carbon filtration systems in the approximately 30 affected residences.

ADESA Impact is preparing an IRA status report that must be submitted to the MDEP by March 30, 2004, and will continue to prepare additional reports as necessary. As of December 31, 2003 ADESA Impact has accrued $0.7 million to cover the costs associated with ongoing testing, remediation and cleanup of the site.

ALLETE maintains pollution liability insurance coverage and has filed a claim with respect to this matter. We and our insurer are determining the availability of insurance coverage at this time.

Other

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, compliance with regulations, rate base and cost of service issues, among other things. While the resolution of such matters could have a material effect on earnings and cash flows in the year of resolution, none of these matters are expected to materially change our present liquidity position, nor have a material adverse effect on our financial condition.

Market Risk

Securities Investments

Our securities investments include certain securities held for an indefinite period of time which are accounted for as available-for-sale securities. Available-for-sale securities are recorded at fair value with unrealized gains and losses included in accumulated other comprehensive income, net of tax. Unrealized losses that are other than temporary are recognized in earnings. At December 31, 2003 our available-for-sale securities portfolio consisted of securities in a grantor trust established to fund certain employee benefits. Our available-for-sale securities portfolio had a fair value of $20.2 million at December 31, 2003 ($20.9 million at December 31, 2002) and a total unrealized after-tax gain of $0.8 million at December 31, 2003 ($2.8 million loss at December 31, 2002). During 2003 we sold the investments we held directly in our publicly-traded emerging technology portfolio and recognized a $2.3 million after-tax loss. These publicly-traded emerging technology investments were accounted for as available-for-sale securities prior to sale.

As part of our emerging technology portfolio, we also have several minority investments in venture capital funds and privately-held start-up companies. These investments are accounted for using the cost method and included with Investments on our consolidated balance sheet. The total carrying value of these investments was $37.5 million at December 31, 2003 ($38.7 million at December 31, 2002). Our policy is to review these investments on a quarterly basis for impairment by assessing such factors as continued commercial viability of products, cash flow and earnings. Any impairment would reduce the carrying value of the investment. We did not record any impairment loss on these investments in 2003 ($1.5 million pretax in 2002; $0.2 million pretax in 2001).

Foreign Currency

Our foreign currency exposure is limited to the conversion of operating results of our Canadian and, to a lesser extent, Mexican subsidiaries. We have not entered into any foreign exchange contracts to hedge the conversion of our Canadian or Mexican operating results into United States dollars. Mexican operations are not material.

Power Marketing

Minnesota Power purchases power for retail sales in our regulated utility service territory and sells excess generation in the wholesale market. We have about 500 MW of nonregulated generation available for sale to the wholesale market. Our nonregulated generation includes about 200 MW from Taconite Harbor in northern Minnesota that was acquired in October 2001. It also includes 275 MW of generation obtained through a 15-year agreement, which commenced in May 2002, with NRG Energy at the Kendall County facility near Chicago, Illinois.

Under the Kendall County agreement, we pay a fixed capacity charge for the right, but not the obligation, to capacity and energy from a 275 MW generating unit. We are responsible for arranging the natural gas fuel supply and are entitled to the electricity produced. Our strategy is to sell a

Interest Rate Sensitive Financial Instruments

	Principal Cash Flow by Expected Maturity Date							
December 31, 2003	**2004**	**2005**	**2006**	**2007**	**2008**	**Thereafter**	**Total**	**Fair Value**
Dollars in Millions								
Long-Term Debt								
Fixed Rate	$4.3	$0.8	$91.3	$115.7	$181.4	$224.7	$618.2	$666.4
Average Interest Rate — %	6.4	7.6	7.7	7.1	7.6	6.3	7.0	
Variable Rate	$33.2	$29.4	$45.8	$3.3	$0.9	$54.4	$167.0	$169.4
Average Interest Rate — % (a)	3.2	2.6	2.1	1.7	3.0	1.6	2.2	

(a) Assumes rate in effect at December 31, 2003 remains constant through remaining term.

significant portion of our nonregulated generation through long-term contracts of various durations. The balance will be sold in the spot market through short-term contracts and in the daily spot market. We currently have long-term capacity sales contracts for 130 MW (100 MW in 2003) of Kendall County generation, with 50 MW expiring in April 2012 and the balance in September 2017. In total, the Kendall County facility operated at a loss in 2003 due to negative spark spreads (the differential between electric and natural gas prices) in the wholesale power market and our resulting inability to cover the fixed capacity charge on approximately 175 MW. We expect the facility to continue to generate losses until such time as spark spreads improve or we are able to enter into additional long-term capacity sales contracts.

Split Rock Energy is a joint venture between Minnesota Power and Great River Energy from which we are withdrawing. Split Rock Energy was formed to combine power supply capabilities and customer loads for power pool operations and generation outage protection. In response to the changing strategies of both parties, as of February 2004 we withdrew from active participation in Split Rock Energy and will terminate our ownership interest upon receipt of FERC approval which is expected in the first half of 2004. We have retained some of the benefits of this partnership, such as joint load and capability reporting. We have resumed performing the functions that provide least cost supply to our retail customers and sell our excess generation.

New Accounting Standards

In January 2004 the FASB issued FASB Staff Position SFAS 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (Act). This Staff Position allows employers who sponsor a postretirement health plan that provides prescription drug benefits to defer recognizing the effects of the Act in accounting for its plan under SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" until authoritative accounting guidance is issued. We provide postretirement health benefits that include prescription drug benefits, and in accordance with this Staff Position, have elected not to reflect the impact of the Act in our 2003 financial statements. We expect the Act will eventually reduce our costs for postretirement health benefits and are reviewing the impact on our accumulated plan benefit obligation and expense going forward.

In May 2003 the FASB issued SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." In general, SFAS 150 established standards for classification and measurement of certain financial instruments with the characteristics of both liabilities and equity. Mandatorily redeemable financial instruments must be classified as a liability and the related payments must be reported as interest expense. The new rules became effective in the third quarter of 2003 for previously existing financial instruments. Beginning with the third quarter of 2003, we reclassified our Mandatorily Redeemable Preferred Securities as a long-term liability and reclassified the quarterly distributions as interest expense. This was a reclassification only and did not impact our results of operations. The Mandatorily Redeemable Preferred Securities were redeemed in December 2003.

In January 2003 the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." In general, a variable interest entity is one with equity investors that do not have voting rights or do not provide sufficient financial resources for the entity to support its activities. Under the new rules, variable interest entities are consolidated by the party that is subject to the majority of the risk of loss or entitled to the majority of the residual returns. In December 2003 the FASB issued Interpretation No. 46R to replace and clarify some of the provisions of Interpretation No. 46. Under Interpretation 46R, the rules became effective on December 15, 2003 for interest in certain structures, and March 15, 2004 for interest in all other structures. We are not a party to any variable interest entity required to be consolidated under Interpretation No. 46R.

Factors that May Affect Future Results

Readers are cautioned that forward-looking statements, including those contained in this Form 10-K, should be read in conjunction with our disclosures under the heading: "Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995" located on page 10 of this Form 10-K and the factors described below. The risks and uncertainties described in this Form 10-K are not the only ones 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 concerns set forth below are realized.

There are risks associated with our restructuring of the Company.

In October 2003 we announced plans to restructure ALLETE by spinning off to ALLETE shareholders our Automotive Services business which will become a publicly traded company doing business as ADESA. Although we expect to complete the restructuring in the third quarter of 2004, there are risks associated with proceeding that could have adverse consequences, including:

- Cost synergies may be eliminated as some fixed operating costs will no longer be shared, thereby potentially adversely affecting the results of operations of the separate entities. For example, costs may increase as a result of having two boards of directors and management teams, as well as separate computer systems, financial audits and SEC compliance requirements.
- The spin-off requires a favorable tax opinion. If not obtained and the spin-off is not consummated for that or any other reason, ALLETE could face challenges in

refocusing the company, suffer a credibility crisis from the standpoint of the financial markets and our shareholders and, consequently, ALLETE's share price could be negatively impacted. If the spin-off is delayed, the cost of the separation could increase.

- Shareholders could experience significant stock price volatility when the businesses begin trading as separate companies. The value of the separate shares could differ significantly from the value of the shares of the combined company as the marketplace determines the price of the separate shares. We are unable to predict how or at what level the shares will trade publicly.
- There is no assurance as to the extent that dividends, if any, will be paid on the shares of ADESA and the amount of dividends to be paid on the shares of ALLETE after the spin-off may vary significantly from the amount currently paid on the shares of the combined company.
- The ability of the separate companies to raise capital may be adversely impacted. The cost of borrowing may increase and new separate credit ratings will be assigned.
- ALLETE as a combined company has benefited from the diversification of business operations. The lack of diversification faced by separate companies may result in more stock price volatility. For example, if there is a downturn in the auto business the share price of ADESA may decline more sharply than if it was part of a more diversified entity.

We are dependent on our ability to successfully access capital markets.

Inability to access capital may limit our ability to execute business plans, pursue improvements or make acquisitions that we may otherwise rely on for future growth. We rely on access to both short-term borrowings, including the issuance of commercial paper, and long-term capital markets as a significant source of liquidity for capital requirements not satisfied by the cash flow from our operations. If we are not able to access capital at competitive rates, the ability to implement our business plans may be adversely affected. Market disruptions or a downgrade of our credit ratings may increase the cost of borrowing or adversely affect our ability to access one or more financial markets.

Our credit ratings could be revised downward.

The current credit ratings for ALLETE's long-term debt are investment grade. A rating reflects only the view of a rating agency, and it is not a recommendation to buy, sell or hold securities. Any rating can be revised upward or downward at any time by a rating agency if such rating agency decides that circumstances warrant such a change. If Standard & Poor's or Moody's were to downgrade ALLETE's long-term ratings, particularly below investment grade, borrowing costs would increase and the potential pool of investors and funding sources would likely decrease.

We are subject to extensive governmental regulations that may have a negative impact on our business and results of operations.

We are subject to prevailing governmental policies and regulatory actions, including those of the United States Congress, Canadian federal government, state and provincial legislatures, the FERC, the MPUC, the FPSC, the NCUC, the PSCW, and various county regulators and city administrators, about allowed rates of return, financings, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of plant facilities, recovery of purchased power and capital investments, and present or prospective wholesale and retail competition (including but not limited to transmission costs) as well as general vehicle-related laws, including vehicle brokerage and auction laws. These governmental regulations significantly influence our operating environment and may affect our ability to recover costs from our customers. We are required to have numerous permits, approvals and certificates from the agencies that regulate our business. We believe the necessary permits, approvals and certificates have been obtained for existing operations and that our business is conducted in accordance with applicable laws; however, we are unable to predict the impact on operating results from the future regulatory activities of any of these agencies. Changes in regulations or the imposition of additional regulations could have an adverse impact on our results of operations.

Recent events in the energy markets that are beyond our control have increased the level of public and regulatory scrutiny in our industry and in the capital markets and have resulted in increased regulation and new accounting standards. The reaction to these events may have negative impacts on our business, financial condition and access to capital.

Our operations pose certain environmental risks which could adversely affect our results of operations and financial condition.

We are subject to extensive environmental laws and regulations affecting many aspects of our present and future operations including air quality, water quality, waste management and other environmental considerations. These laws and regulations can result in increased capital, operating, and other costs, as a result of compliance, remediation, containment and monitoring obligations, particularly with regard to laws relating to power plant emissions. These laws and regulations generally require us to obtain and comply with a wide variety of environmental licenses, permits, inspections and other approvals. Both public officials and private individuals may seek to enforce applicable environmental laws and regulations. We cannot predict the financial or operational outcome of any related litigation that may arise.

There are no assurances that existing environmental regulations will not be revised or that new regulations seeking to protect the environment will not 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 a material effect on our results of operations.

We cannot predict with certainty the amount or timing of all future expenditures related to environmental matters because of the difficulty of estimating clean up costs. There is also uncertainty in quantifying liabilities under environmental laws that impose joint and several liability on all potentially responsible parties. (See Environmental and Other Matters.)

In the vehicle redistribution industry, large numbers of vehicles, including damaged vehicles at salvage vehicle auctions, are stored at auction facilities and, during that time, releases of fuel, motor oil and other fluids may occur, resulting in soil, surface water, air or groundwater contamination. In addition, we generate and/or store petroleum products and other hazardous materials, including wastewater, waste solvents and used oil run-off from our vehicle reconditioning and detailing facilities, and body shops at our facilities may release harmful air emissions associated with painting. We could incur substantial expenditures for preventative, investigative or remedial action and could be exposed to liability arising from our operations, contamination by previous users of our acquired facilities, or the disposal of our waste at off-site locations. Any such expenditures or liabilities could have a material adverse effect on our results of operations and financial condition.

The operation and maintenance of our generating facilities involves risks that could significantly increase the cost of doing business.

The operation of generating facilities involves many risks, including start up risks, breakdown or failure of facilities, lack of sufficient capital to maintain the facilities, the dependence on a specific fuel source 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, the occurrence of any of which could result in lost revenue and/or increased expenses. A significant portion of Minnesota Power's facilities was constructed many years ago. In particular, older generating equipment, even if maintained in accordance with good engineering practices, may require significant capital expenditures to keep it operating at peak efficiency. This equipment is also likely to require periodic upgrading and improvement. Minnesota Power could be subject to costs associated with any unexpected failure to produce power, including failure caused by breakdown or forced outage, as well as repairing damage to facilities due to storms, natural disasters, wars, terrorist acts and other catastrophic events. Further, our ability to successfully and timely complete capital improvements to existing facilities or other capital projects is contingent upon many variables and subject to substantial risks. Should any such efforts be unsuccessful, we could be subject to additional costs and/or the write-off of our investment in the project or improvement.

Energy Services must have adequate and reliable transmission and distribution facilities to deliver our electricity to our customers.

Minnesota Power depends on transmission and distribution facilities owned and operated by other utilities, as well as its own such facilities, to deliver the electricity it produces and sells to its customers, as well as to other energy suppliers. If transmission capacity is inadequate, our ability to sell and deliver electricity may be hindered, we may have to forgo sales or we may have to buy more expensive wholesale electricity that is available in the capacity-constrained area. The cost to provide service to these customers may exceed the cost to service other customers, resulting in lower gross margins. In addition, any infrastructure failure that interrupts or impairs delivery of electricity to our customers could negatively impact the satisfaction of our customers with our service.

The price of one of our major products, electricity, and/or one of our major expenses, fuel, may be volatile.

Volatility in market prices for fuel and electricity may result from:

- severe or unexpected weather conditions;
- seasonality;
- changes in electricity usage;
- the current diminished liquidity in the wholesale power markets as well as any future illiquidity in these or other markets;
- transmission or transportation constraints, inoperability or inefficiencies;
- availability of competitively priced alternative energy sources;
- changes in supply and demand for energy commodities;
- changes in power production capacity;
- outages at Minnesota Power's generating facilities or those of our competitors;
- changes in production and storage levels of natural gas, lignite, coal and crude oil and refined products;
- natural disasters, wars, sabotage, terrorist acts, embargoes and other catastrophic events; and
- federal, state, local and foreign energy, environmental and other regulation and legislation.

Since fluctuations in fuel expense related to our regulated utility operations are passed on to customers through our fuel clause, risk of volatility in market prices for fuel and electricity mainly impacts our nonregulated operations at this time.

The volatile nature of vehicle sales may adversely affect our profitability.

The vehicle industry is cyclical and historically has experienced periodic downturns characterized by oversupply and weak demand. Many factors affect the industry, including general economic conditions and consumer confidence, fuel prices, the level of discretionary personal income, unemployment rates, interest rates, credit availability and insurance premiums.

New and used vehicle sales substantially slowed immediately following the terrorist attacks of September 11, 2001. In response, manufacturers introduced new incentives (including

0% financing) and rental car companies began to downsize their inventories. This led to decreases in the prices of both used and salvage vehicles and a temporary decline in conversion percentages in the auction industry because the prices that buyers were willing to pay for vehicles did not match the prices that sellers were willing to accept. In 2002 the manufacturers extended and increased the incentives leading to additional declines in both used vehicle prices and conversion percentages. We are not able to determine the long-term consequences the terrorist attacks and/or subsequent outbreaks of hostilities might have on general economic conditions, our industry, or ADESA, nor are we able to predict how used vehicle prices and conversion percentages may be affected by new and additional incentives or other changes by the manufacturers aimed at the new car market.

Used vehicle sales are driven by consumer demand. As consumer demand fluctuates, the volume and prices of used vehicles may be affected and the demand for used vehicles at auction by dealers may likewise be affected. The demand for used vehicles at auction by dealers may therefore have an effect on the wholesale price of used vehicles and the conversion percentage of vehicles sold at auction.

The number of new and used vehicles that are leased by consumers affects the supply of vehicles coming to auction. As manufacturers and other lenders have decreased the number of leases in the last few years and extended the lease terms of some of the leases that were written, the number of off-lease vehicles available at auction declined in 2003 and that decline is expected to continue in 2004 and 2005. We are not able to predict the manufacturers' and other lenders' approaches to leasing, and thus future volumes of off-lease vehicles may be affected based upon leasing trends.

Program vehicles are vehicles used by rental car companies and other companies with individual corporate fleets of vehicles that are returned to manufacturers through repurchasing programs. The volume of program vehicles and the terms of the programs have an effect on the volume of used vehicles available for sale at auction since the majority of these vehicles are redistributed via the used vehicle auction process.

Repossessed vehicles are a source of volume for used vehicle auctions and are dependent upon both economic conditions and the policies of lenders regarding their credit practices. As these economic conditions and policies change, the volume of vehicles available for sale at auction may also be affected.

Insurance companies are the main source of salvage vehicles available for sale at auction. The number of vehicles branded as salvage is dependent upon several factors including government regulations, the extent of damage to the vehicle, the number of accidents, and the policies of the insurance companies with respect to claims settlement and redistribution of the salvage vehicles.

If the volume of used or salvage vehicles sold at our auctions were to decline due to any of the factors described above or for any other reason, the revenue we earn from successful auction transactions and ancillary services would decline. In addition, the fixed costs associated with our auction facilities would remain relatively constant. As a result of these consequences, our profitability could be adversely affected.

ALLETE's Energy Services business is subject to increased competition.

The independent power industry includes numerous strong and capable competitors, many of which have extensive experience in the operation, acquisition and development of power generation facilities. Energy Services' competition is based primarily on price and reputation for quality, safety and reliability. The electric utility and natural gas industries are also experiencing increased competitive pressures as a result of consumer demands, technological advances, deregulation, greater availability of natural gas-fired generation and other factors.

The vehicle redistribution industry is highly competitive and we may not be able to compete successfully.

We face significant competition for the supply of used and salvage vehicles and for the buyers of those vehicles. We believe our principal competitors include other used and/or salvage vehicle auction companies, wholesalers, dealers, manufacturers and dismantlers, a number of whom may have established relationships with sellers and buyers of vehicles and may have greater financial resources than we have. Due to the limited number of sellers of used and salvage vehicles, the absence of long-term contractual commitments between us and our customers and the increasingly competitive market environment, there can be no assurance that our competitors will not gain market share at our expense.

We may encounter significant competition for local, regional and national supply agreements with sellers of used and salvage vehicles. There can be no assurance that the existence of other local, regional or national contracts entered into by our competitors will not have a material adverse effect on our business or our expansion plans. Furthermore, we are likely to face competition from major competitors in the acquisition of auction facilities, which could significantly increase the cost of such acquisitions and thereby materially impede our expansion objectives or have a material adverse effect on our results of operations. These potential competitors may include consolidators of used vehicle auctions, vehicle dismantling businesses, organized salvage vehicle buying groups, vehicle manufacturers and on-line auction companies. While most of our institutional customers have abandoned or reduced efforts to sell vehicles directly without the use of service providers such as us, there can be no assurance that this trend will continue, which could adversely affect our market share, results of operations and financial condition.

We may also encounter competition in our floorplan financing business. The floorplan financing sector is

characterized by diverse and fragmented competition. AFC's competition includes the financing arms of other auction providers, other speciality lenders, banks and other financial institutions. There can be no assurance that the existence of other floorplan financing providers nor the entrance of new providers to the sector will not have a material adverse effect on AFC, its ability to compete successfully in the floorplan financing sector, or our overall ability to compete in the vehicle redistribution industry.

Additionally, existing or new competitors may be significantly larger and have greater financial and marketing resources than we have; therefore, there can be no assurance that we will be able to compete successfully in the future.

Increased use of on-line wholesale auctions may diminish our supply of vehicles.

Direct sales of used vehicles by institutional customers and large dealer groups through internally developed or third party on-line auctions have largely replaced telephonic and other non-auction methods, becoming an increasing portion of overall used vehicle redistribution over the past several years. In addition, a portion of the vehicles that were sold through a physical auction are now being sold on-line. Typically, on-line auctions serve to redistribute vehicles that have come off lease. The extent of use of direct, on-line systems varies among institutional customers and currently comprises approximately 3% to 5% of overall used vehicle auction sales. In addition, some of our competitors have begun to offer on-line auctions as all or part of their auction business and other on-line auctions now include used vehicles among the products offered at their auctions. On-line auctions or other methods of redistribution may diminish both the quality and quantity and reduce the value of vehicles sold through traditional auction facilities. Although we have embraced the Internet and offer on-line auctions and services as part of our standard service offerings, we cannot predict what portion of overall sales will be conducted through on-line auctions or other redistribution methods in the future and what impact this may have on our auction facilities.

Our operations are weather sensitive.

Our results of operations can be affected by changes in the weather. Weather conditions directly influence the demand for electricity and natural gas, affect the price of energy commodities and affect the ability to perform energy and automotive services. Auction volumes tend to decline during prolonged periods of winter weather conditions. In addition, mild weather conditions and decreases in traffic volume can lead to a decline in the available supply of salvage vehicles because fewer traffic accidents occur, resulting in fewer damaged vehicles overall. We cannot predict future weather conditions and as a result, adverse weather conditions could negatively affect our operations and financial condition.

Seasonality of the auction business affects our quarterly revenue and earnings.

Generally, the volume of vehicles sold at auction is highest in the first and second calendar quarters of each year and slightly lower in the third quarter. Fourth quarter sales are generally lower than all other quarters. This seasonality is affected by several factors including weather, the timing of used vehicles available for sale from the institutional customers, holidays, and the seasonality of the retail market for used vehicles which affects the demand side of the auction industry. As a result, the revenue and operating expenses related to volume will fluctuate accordingly on a quarterly basis.

If our significant Energy Services customers are negatively impacted by world economics, our revenue may be negatively impacted.

Our Large Power Customers are impacted by world economics that affect their competitive position and profitability. Taconite producers and paper and wood products customers served by Minnesota Power compete in this world marketplace. Their inability to compete in their global markets could have a material adverse effect on their operations and continuation as a business. Any such failure could have a material adverse effect on Energy Services results of operations and the surrounding communities we serve.

We are dependent on good labor relations.

We believe our relations to be good with our approximately 13,000 employees.

Energy Services has approximately 1,400 full-time employees, of which approximately 700 are either a member of the International Brotherhood of Electrical Workers Local 31 or Local 1593. Failure to successfully renegotiate labor agreements could adversely affect the services we provide and our results of operations. The labor agreements with Local 31 expire on January 31, 2006. Negotiations are underway for a new contract with Local 1593. The existing agreement with Local 1593 ends on March 31, 2004.

In addition to its regular employees, Automotive Services utilizes temporary labor services to assist in handling the vehicles consigned to it during periods of peak volume and staff shortages. Many of Automotive Services' employees, both full-time and part-time, are unskilled, and in periods of strong economic growth, we may find it difficult to compete for sufficient unskilled labor. Many of the services we provide are outsourced to third party providers that perform the services either on-site or off-site. The use of third party providers depends upon the resources available at each auction facility as well as peaks in the volume of vehicles offered at auction. If we are unable to maintain our full-time, part-time or contract workforce or the necessary relationships with third party providers, our operations may be adversely affected.

In addition, auctioneers at our auctions are highly skilled individuals who are essential to the successful operation of our auction business. Nearly all of our auctioneers are independent contractors who provide their services for a daily or weekly rate. If we are unable to retain a sufficient number of experienced auctioneers, our operations may be adversely affected.

Our Automotive Services operations subject us to the risk of collusion, misconduct and other improper business practices by our Automotive Services employees and third parties.

In the past, some of our Automotive Services employees have acted in collusion with one another, with individual contractors or third party service providers, and/or with customers, in order to manipulate our policies, procedures and systems. Some of our auction employees also have engaged in misconduct or wrongdoing, including isolated acts of dishonesty and malfeasance, exercised poor judgment or otherwise conducted business in an improper manner. In addition, customers acting in collusion have redistributed vehicles through our auctions on terms that were not arms length. As a result of these activities, our services have been sold at a discount or for no fee, credit has been extended outside of the normal course of operations, unnecessary services have been provided and operating costs have increased. We have enhanced our internal control systems and conduct random on-site audits of auction facilities to identify and minimize these activities. While collusion, misconduct and other improper business practices have not had a material adverse effect on our operating results in the past, we cannot assure you that activities similar to those described above will not occur in the future or will be detected by us in a timely manner or before a material loss is incurred. If our internal controls fail to prevent future acts of collusion, misconduct and other improper business practices, resulting losses could have a material adverse effect on our results of operations and financial condition.

If we are not able to retain our executive officers and key employees, we may not be able to implement our business strategy and our business could suffer.

If we fail to retain our executive officers or key employees, our business could suffer. We may have difficulty in retaining and attracting customers, developing new services, negotiating favorable agreements with customers and providing acceptable levels of customer service. Although leadership changes will occur in connection with the spin-off, we cannot predict whether significant resignations will occur. The success of our business heavily depends on the leadership of our executive officers, all of whom are employees-at-will and none of whom are subject to any agreements not to compete. If we lose the service of one or more of our executive officers or key employees, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, we may not be able to successfully manage our business or achieve our business objectives.

We assume the settlement risk for all vehicles sold through our auctions.

As part of the fees earned for the services we provide relative to the sale of each vehicle at auction, we assume the risk associated with collecting the gross sales proceeds from buyers and likewise assume responsibility for distributing to sellers the net sales proceeds of vehicles. The fees for each vehicle are collected by adding the buyer-related fees to the gross sales proceeds due from the buyer and deducting the seller-related fees from the gross sales proceeds prior to distributing the net sales proceeds to the seller. The amount we report as revenue for each vehicle only represents the fees associated with our services and does not include the gross sales price of the consigned vehicle. As a result, the accounts receivable from buyers are much larger on a per vehicle basis than the combined seller- and buyer-related fees associated with each transaction. We do not have recourse against sellers for any buyer's failure to satisfy its debt. Since our revenue for each vehicle does not include the gross sales proceeds, failure to collect the receivables in full would result in a net loss up to the gross sales proceeds on a per vehicle basis in addition to any expenses incurred to collect the receivables and to provide the services associated with the vehicle. Although we take steps to mitigate this risk, if we are unable to collect payments on a large number of vehicles our resulting payment obligations and decreased fee revenue may have a material adverse effect on our results of operations and financial condition.

In addition, in the ordinary course of business, it is our responsibility to fully disclose any defects or other information relevant to the value of a vehicle sold through our auctions that we have discovered or of which we have been informed by the seller. In cases where we fail to properly disclose information about a particular vehicle, we typically refund the fees collected and void the sale of the vehicle. If we are unable to reach a settlement satisfactory to the seller, we generally purchase the vehicle, which subjects us to the costs and risks of resale.

We rely heavily on technology to protect our rights with respect to our businesses and must adapt to evolving applications. Changes in technology could cause our services to become obsolete and, as a result, we may lose customers.

In both our Energy Services and Automotive Services businesses, technology is an integral part of our operations and is subject to evolving industry standards. The information systems and processes necessary to support risk management, sales, customer service and procurement and supply are new, complex and extensive. To be successful, we must adapt to this evolving market by continually improving the responsiveness, functionality and features of our services and systems to meet our customers' changing needs. We may not be successful in developing or acquiring technology which is competitive and responsive to the needs of our customers and might lack sufficient resources to continue to make the necessary investments in technology to compete with our competitors. Without the timely introduction of new services and enhancements that take advantage of the latest technology, some of our services could become obsolete over time and we could lose a number of our customers.

We develop software internally and through outsourcing relationships, and we have also licensed and may license in the future, copyrighted computer systems software and trade secrets from third parties. While we attempt to ensure that our intellectual property and similar proprietary rights are protected and that the third party rights we need are licensed

to us when entering into business relationships, our business partners, consultants or other third parties may take actions that could materially and adversely affect our rights or the value of our intellectual property, similar proprietary rights or reputation. In addition, if we are subject to any infringement claims, such claims may have an adverse effect on our business operations.

Our operations may be restricted by vehicle-related or lending laws and other regulations, including vehicle brokerage and auction laws.

Our operations are subject to regulation, supervision and licensing under various U.S. or Canadian federal, state, provincial and local statutes, ordinances and regulations. Each auction is subject to laws in the state or province in which it operates which regulate auctioneers and/or vehicle dealers. Some of the transport vehicles used at our auctions are regulated by the U.S. Department of Transportation or the Canadian Transportation Agency. The acquisition and sale of salvage and theft recovered vehicles is regulated by governmental agencies in each of the locations in which we operate. In many states and provinces, regulations require that the title of a salvage vehicle be forever "branded" with a salvage notice in order to notify prospective purchasers of the vehicle's previous salvage status. Some state, provincial and local regulations also limit who can purchase salvage vehicles, as well as determine whether a salvage vehicle can be sold as rebuildable or must be sold for parts only. Such regulations can reduce the number of potential buyers of vehicles at salvage auctions. In addition to the regulation of the sales and acquisition of vehicles, we are also subject to various local zoning requirements with regard to the location and operation of our auction and storage facilities.

If we fail to comply with applicable regulations and requirements, we could be subject to civil or criminal liability and the imposition of liens or fines. In addition, existing regulations may be revised or reinterpreted, new laws and regulations may be adopted or become applicable to us or our facilities, and future changes in laws and regulation may have a detrimental effect on our businesses.

A portion of our revenue may be derived from non-United States sources, which exposes us to foreign exchange and other risks.

Approximately 10% of our consolidated revenue is derived from our Canadian facilities. We also conduct operations in Mexico. As a result, fluctuations between United States and non-United States currency values may adversely affect our results of operations and financial position. In addition, there are tax inefficiencies in repatriating cash flow from non-United States subsidiaries. To the extent such repatriation is necessary for us to meet our debt service or other obligations, these tax inefficiencies may adversely affect us.

Adequate insurance protection may not be cost effective or available to minimize risk.

Insurance, warranties or performance guarantees may not cover any or all of the lost revenue or increased expenses, including the cost of replacement power and cancellation of sale days at auction sites. Likewise, our ability to obtain insurance, and the cost of and coverage provided by such insurance, could be affected by events outside our control.

Risks associated with acquisitions may hinder our ability to increase revenue and earnings.

Both the energy and vehicle redistribution industries are considered mature industries in which low single digit growth is expected in industry unit sales. Accordingly, our future growth depends in large part on our ability to increase our volumes relative to our competition, acquire additional businesses, manage expansion, control costs in our operations, introduce new services, and consolidate future acquisitions into existing operations. In pursuing a strategy of acquiring other businesses, we face risks commonly encountered with growth through acquisitions. These risks include, but are not limited to:

- incurring significantly higher capital expenditures and operating expenses;
- failing to assimilate the operations and personnel of the acquired businesses;
- entering new markets with which we are unfamiliar;
- potential undiscovered liabilities at acquired businesses;
- disrupting our ongoing business;
- diverting our limited management resources;
- failing to maintain uniform standards, controls and policies;
- impairing relationships with employees and customers as a result of changes in management; and
- increasing expenses for accounting and computer systems, as well as integration difficulties.

We may not adequately anticipate all of the demands that our growth will impose on our systems, procedures and structures, including our financial and reporting control systems, data processing systems and management structure. If we cannot adequately anticipate and respond to these demands, our business could be materially harmed.

Although we conduct what we believe to be a prudent level of investigation regarding the operating condition of the businesses we purchase, in light of the circumstances of each transaction, an unavoidable level of risk remains regarding the actual operating condition of these businesses. Until we actually assume operating control of such business assets, we may not be able to ascertain the actual value of the acquired entity.

We cannot guarantee that greenfield development or relocation of auction sites will be profitable.

The costs of greenfield development or relocation of our auction sites may be substantial. In addition, we may encounter delays and scope changes while an auction site is under development that cause our capital investment to increase and our returns to be lower than expected. Although our strategy is to secure support from institutional customers and insurance companies prior to developing new or relocated facilities, there is no guarantee that new or relocated facilities will be able to attract these customers or deliver sustained revenue or profit.

We can offer you no assurances that we will be able to continue executing an acquisition strategy without the costs of future acquisitions escalating.

Although there are potential acquisition candidates that fit our acquisition criteria, we are not certain that we will be able to consummate any such transactions in the future or identify those candidates that would result in the most successful combinations, or that future acquisitions will be able to be consummated at acceptable prices and terms. In addition, increased competition for acquisition candidates could result in fewer acquisition opportunities for us and higher acquisition prices. The magnitude, timing, pricing and nature of future acquisitions will depend upon various factors, including:

- the availability of suitable acquisition candidates;
- competition with other industry groups or new industry consolidators for suitable acquisitions;
- the negotiation of acceptable terms;
- our financial capabilities;
- the availability of skilled employees to manage the acquired companies; and
- general economic and business conditions.

We may be required to file applications and obtain clearances under applicable federal antitrust laws before completing an acquisition. These regulatory requirements may restrict or delay our acquisitions, and may increase the cost of completing acquisitions.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

See Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition - Market Risk for information related to quantitative and qualitative disclosure about market risk.

Item 8. Financial Statements and Supplementary Data

See our consolidated financial statements as of December 31, 2003 and 2002 and for each of the three years in the period ended December 31, 2003, and supplementary data, also included, which are indexed in Item 15(a).

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of management, including our chief executive officer and chief financial officer, as of the end of the period covered by this Form 10-K. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings. There has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART III

Item 10. Directors and Executive Officers of the Registrant

Unless otherwise stated, the information required for this Item is incorporated by reference herein from our Proxy Statement for the 2004 Annual Meeting of Shareholders (2004 Proxy Statement). Our 2004 Proxy Statement will be filed with the SEC within 120 days after the end of our 2003 fiscal year.

- **Directors.** The information regarding directors will be included in the "Election of Directors" section;
- **Audit Committee Financial Expert.** The information regarding the audit committee financial expert will be included in the "Report of the Audit Committee" section;
- **Executive Officers.** The information regarding executive officers is included in Part I of this Form 10-K;
- **Section 16(a) Compliance.** The information regarding Section 16(a) compliance will be included in the "Section 16(a) Beneficial Ownership Reporting Compliance" section; and
- **Code of Ethics.** We have adopted a written Code of Ethics that applies to all of our employees, including our chief executive officer, chief financial officer and controller. A copy of our Code of Ethics is available on our website at www.allete.com and print copies are available to any shareholder that requests a copy. Any amendment to the Code of Ethics or any waiver of the Code of Ethics will be disclosed on our website at www.allete.com promptly following the date of such amendment or waiver.

Item 11. Executive Compensation

The information required for this Item is incorporated by reference herein from the "Compensation of Executive Officers" section in our 2004 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required for this Item is incorporated by reference herein from the "Security Ownership of Beneficial Owners and Management" and the "Equity Compensation Plan Information" sections in our 2004 Proxy Statement.

Item 13. Certain Relationships and Related Transactions

None.

Item 14. Principal Accountant Fees and Services

The information required by this Item is incorporated by reference herein from the "Report of the Audit Committee" section in our 2004 Proxy Statement.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Certain Documents Filed as Part of this Form 10-K.

(1) Financial Statements **Page**

(2) Financial Statement Schedules

All other schedules have been omitted either because the information is not required to be reported by ALLETE or because the information is included in the consolidated financial statements or the notes.

(3) Exhibits including those incorporated by reference.

Exhibit Number

*2(a) - First Amended and Restated Utility System Asset Acquisition Agreement (without Appendices), entered into on August 25, 2003, by and among Hernando County, the City of Marco Island, the City of Palm Coast, Osceola County, Florida Governmental Utility Authority, the City of Deltona and Florida Water Services Corporation (filed as Exhibit 2 to the August 27, 2003 Form 8-K, File No. 1-3548).

2(b) - Stock Purchase Agreement (without Exhibits and Schedules), dated November 20, 2003, by and between Philadelphia Suburban Corporation (now Aqua America, Inc.), as Purchaser, and ALLETE Water Services, Inc., as Shareholder.

*3(a)1 - Articles of Incorporation, amended and restated as of May 8, 2001 (filed as Exhibit 3(b) to the March 31, 2001 Form 10-Q, File No. 1-3548).

*3(a)2 - Amendment to Certificate of Assumed Name, filed with the Minnesota Secretary of State on May 8, 2001 (filed as Exhibit 3(a) to the March 31, 2001 Form 10-Q, File No. 1-3548).

*3(b) - Bylaws, as amended effective May 8, 2001 (filed as Exhibit 3(c) to the March 31, 2001 Form 10-Q, File No. 1-3548).

Exhibit Number

*4(a)1 - Mortgage and Deed of Trust, dated as of September 1, 1945, between Minnesota Power & Light Company (now ALLETE) and The Bank of New York (formerly Irving Trust Company) and Douglas J. MacInnes (successor to Richard H. West), Trustees (filed as Exhibit 7(c), File No. 2-5865).

*4(a)2 - Supplemental Indentures to ALLETE's Mortgage and Deed of Trust:

Number	Dated as of	Reference File	Exhibit
First	March 1, 1949	2-7826	7(b)
Second	July 1, 1951	2-9036	7(c)
Third	March 1, 1957	2-13075	2(c)
Fourth	January 1, 1968	2-27794	2(c)
Fifth	April 1, 1971	2-39537	2(c)
Sixth	August 1, 1975	2-54116	2(c)
Seventh	September 1, 1976	2-57014	2(c)
Eighth	September 1, 1977	2-59690	2(c)
Ninth	April 1, 1978	2-60866	2(c)
Tenth	August 1, 1978	2-62852	2(d)2
Eleventh	December 1, 1982	2-56649	4(a)3
Twelfth	April 1, 1987	33-30224	4(a)3
Thirteenth	March 1, 1992	33-47438	4(b)
Fourteenth	June 1, 1992	33-55240	4(b)
Fifteenth	July 1, 1992	33-55240	4(c)
Sixteenth	July 1, 1992	33-55240	4(d)
Seventeenth	February 1, 1993	33-50143	4(b)
Eighteenth	July 1, 1993	33-50143	4(c)
Nineteenth	February 1, 1997	1-3548 (1996 Form 10-K)	4(a)3
Twentieth	November 1, 1997	1-3548 (1997 Form 10-K)	4(a)3
Twenty-first	October 1, 2000	333-54330	4(c)3
Twenty-second	July 1, 2003	1-3548 (June 30, 2003 Form 10-Q)	4

*4(b)1 - Indenture (for Unsecured Debt Securities), dated as of February 1, 2001, between ALLETE and LaSalle Bank National Association, as Trustee (filed as Exhibit 4(d)1, File Nos. 333-57104, 333-57104-01 and 333-57104-02).

*4(b)2 - Officer's Certificate, dated February 21, 2001, establishing the terms of the 7.80% Senior Notes, due February 15, 2008, of ALLETE (filed as Exhibit 4(d)2, File Nos. 333-57104, 333-57104-01 and 333-57104-02).

*4(c)1 - Mortgage and Deed of Trust, dated as of March 1, 1943, between Superior Water, Light and Power Company and Chemical Bank & Trust Company and Howard B. Smith, as Trustees, both succeeded by U.S. Bank Trust N.A., as Trustee (filed as Exhibit 7(c), File No. 2-8668).

PART IV

Exhibit Number

*4(c)2 - Supplemental Indentures to Superior Water, Light and Power Company's Mortgage and Deed of Trust:

Number	Dated as of	Reference File	Exhibit
First	March 1, 1951	2-59690	2(d)(1)
Second	March 1, 1962	2-27794	2(d)1
Third	July 1, 1976	2-57478	2(e)1
Fourth	March 1, 1985	2-78641	4(b)
Fifth	December 1, 1992	1-3548 (1992 Form 10-K)	4(b)1
Sixth	March 24, 1994	1-3548 (1996 Form 10-K)	4(b)1
Seventh	November 1, 1994	1-3548 (1996 Form 10-K)	4(b)2
Eighth	January 1, 1997	1-3548 (1996 Form 10-K)	4(b)3

*4(d) - Rights Agreement, dated as of July 24, 1996, between Minnesota Power & Light Company (now ALLETE) and the Corporate Secretary of the Company, as Rights Agent (filed as Exhibit 4 to the August 2, 1996 Form 8-K, File No. 1-3548).

*4(e) - Indenture (for Unsecured Debt Securities), dated as of May 15, 1996, between ADESA Corporation and The Bank of New York, as Trustee, relating to the ADESA Corporation's 7.70% Senior Notes, Series A, Due 2006, and its 8.10% Senior Notes, Series B, Due 2010 (filed as Exhibit 4(k) to the 1996 Form 10-K, File No. 1-3548).

*4(f) - Guarantee of the Company, dated as of May 30, 1996, relating to the ADESA Corporation's 7.70% Senior Notes, Series A, Due 2006 (filed as Exhibit 4(l) to the 1996 Form 10-K, File No. 1-3548).

*4(g) - ADESA Corporation Officer's Certificate 1-D-1, dated May 30, 1996, relating to the ADESA Corporation's 7.70% Senior Notes, Series A, Due 2006 (filed as Exhibit 4(m) to the 1996 Form 10-K, File No. 1-3548).

*4(h) - Guarantee of Minnesota Power, Inc. (now ALLETE), dated as of March 30, 2000, relating to ADESA Corporation's 8.10% Senior Notes, Series B, Due 2010 (filed as Exhibit 4(a) to the March 31, 2000 Form 10-Q, File No. 1-3548).

*4(i) - ADESA Corporation Officer's Certificate 2-D-2, dated as of March 30, 2000, relating to ADESA Corporation's 8.10% Senior Notes, Series B, Due 2010 (filed as Exhibit 4(b) to the March 31, 2000 Form 10-Q, File No. 1-3548).

Exhibit Number

*10(a) - Participation Agreement, dated as of March 31, 2000, among Asset Holdings III, L.P., as Lessor, ADESA Corporation, as Lessee, SunTrust Bank, as Credit Bank, and Cornerstone Funding Corporation I, as Issuer (filed as Exhibit 10(a) to the March 31, 2000 Form 10-Q, File No. 1-3548).

*10(b) - Lease Agreement, dated as of March 31, 2000, between Asset Holdings III, L.P., as Lessor, and ADESA Corporation, as Lessee (filed as Exhibit 10(b) to the March 31, 2000 Form 10-Q, File No. 1-3548).

*10(c) - Reimbursement Agreement, dated as of March 31, 2000, between SunTrust Bank, as Credit Bank, and Asset Holdings III, L.P., as Lessor (filed as Exhibit 10(c) to the March 31, 2000 Form 10-Q, File No. 1-3548).

*10(d) - Appendix I to Participation Agreement, Lease Agreement and Reimbursement Agreement, all which are dated as of March 31, 2000, relating to the Lease Financing for ADESA Corporation Auto Auction Facilities (filed as Exhibit 10(d) to the March 31, 2000 Form 10-Q, File No. 1-3548).

*10(e) - Assignment of Lease and Rents (without Exhibit A) entered into as of March 31, 2000, by and between Asset Holdings III, L.P., as Lessor, and SunTrust Bank, as Credit Bank (filed as Exhibit 10(e) to the March 31, 2000 Form 10-Q, File No. 1-3548).

*10(f) - Limited Guaranty of Minnesota Power, Inc. (now ALLETE), dated as of March 31, 2000, relating to the Lease Financing for ADESA Corporation Auto Auction Facilities (filed as Exhibit 10(f) to the March 31, 2000 Form 10-Q, File No. 1-3548).

*10(g) - Borrower Promissory Note, dated April 3, 2000, between Asset Holdings III, L.P. as Borrower, and Cornerstone Funding Corporation I, as Issuer (filed as Exhibit 10(d) to the June 30, 2003 Form 10-Q, File No. 1-3548).

*10(h) - Trust Indenture (without Exhibits) between Development Authority of Fulton County and SunTrust Bank, as Trustee, dated as of December 1, 2002 (filed as Exhibit 10(k) to the 2002 Form 10-K, File No. 1-3548).

*10(i) - Bond Purchase Agreement (without Exhibits), dated December 1, 2002, for the Development Authority of Fulton County Taxable Economic Development Revenue Bonds (ADESA Atlanta, LLC Project) Series 2002 (filed as Exhibit 10(l) to the 2002 Form 10-K, File No. 1-3548).

Exhibit Number

*10(j) - Lease Agreement (without Exhibits) between Development Authority of Fulton County and ADESA Atlanta, LLC, dated as of December 1, 2002 (filed as Exhibit 10(m) to the 2002 Form 10-K, File No. 1-3548).

*10(k) - Term Loan Agreement (without Exhibits), dated as of June 30, 2003, among ADESA California, Inc., as Borrower, the Lenders Party Thereto, and SunTrust Bank, as Administrative Agent (filed as Exhibit 10(b) to the June 30, 2003 Form 10-Q, File No. 1-3548).

*10(l) - Guaranty Agreement, dated as of June 30, 2003, among ADESA and ALLETE, as Guarantors of ADESA California, Inc., the Borrower, and SunTrust Bank, the Administrative Agent (filed as Exhibit 10(c) to the June 30, 2003 Form 10-Q, File No. 1-3548).

*10(m) - Receivables Purchase Agreement dated as of May 31, 2002, among AFC Funding Corporation, as Seller, Automotive Finance Corporation, as Servicer, Fairway Finance Corporation, as initial Purchaser, BMO Nesbitt Burns Corp., as initial Agent and as Purchaser Agent for Fairway Finance Corporation and XL Capital Assurance Inc., as Insurer (filed as Exhibit 10(a) to the June 30, 2002 Form 10-Q, File No. 1-3548).

*10(n) - Amended and Restated Purchase and Sale Agreement dated as of May 31, 2002, between AFC Funding Corporation and Automotive Finance Corporation (filed as Exhibit 10(b) to the June 30, 2002 Form 10-Q, File No. 1-3548).

*10(o)1 - Wholesale Power Coordination and Dispatch Operating Agreement, dated April 14, 2000, between Minnesota Power, Inc. (now ALLETE) and Split Rock Energy LLC (filed as Exhibit 10(a) to the June 30, 2000 Form 10-Q, File No. 1-3548).

*10(o)2 - Letter addressed to the Federal Energy Regulatory Commission, dated April 21, 2000, amending the Wholesale Power Coordination and Dispatch Operating Agreement, dated April 14, 2000, between Minnesota Power, Inc. (now ALLETE) and Split Rock Energy LLC (filed as Exhibit 10(b) to the June 30, 2000 Form 10-Q, File No. 1-3548).

10(o)3 - Amended Wholesale Power Coordination and Dispatch Operating Agreement, dated January 30, 2004, between Minnesota Power, Inc. (now ALLETE) and Split Rock Energy LLC.

Exhibit Number

10(p) - Amended and Restated Withdrawal Agreement (without Exhibits and Schedules), dated January 30, 2004, by and between Great River Energy and Minnesota Power (now ALLETE). [Portions of this exhibit have been omitted pursuant to a request for confidential treatment and filed separately with the SEC.]

*10(q) - Power Purchase and Sale Agreement, dated as of May 29, 1998, between Minnesota Power, Inc. (now ALLETE) and Square Butte Electric Cooperative (filed as Exhibit 10 to the June 30, 1998 Form 10-Q, File No. 1-3548).

*10(r) - Credit Agreement, dated as of July 18, 2003, among ALLETE, as Borrower, Wells Fargo Bank, National Association, as Sole Lead Arranger and Administrative Agent, Bank One, N.A., as Syndication Agent, and the Other Financial Institutions Party Thereto (filed as Exhibit 10(a) to the June 30, 2003 Form 10-Q, File No. 1-3548).

10(s) - Third Amended and Restated Committed Facility Letter (without Exhibits), dated December 23, 2003, to ALLETE from LaSalle Bank National Association, as Agent.

+*10(t)1 - Minnesota Power (now ALLETE) Executive Annual Incentive Plan, as amended, effective January 1, 1999 with amendments through January 2003 (filed as Exhibit 10 to the September 30, 2003 Form 10-Q, File No. 1-3548).

+10(t)2 - November 2003 Amendment to the Minnesota Power (now ALLETE) Executive Annual Incentive Plan.

+10(u) - ALLETE and Affiliated Companies Supplemental Executive Retirement Plan, as amended and restated, effective January 1, 2004.

+*10(v)1 - Executive Investment Plan-I, as amended and restated, effective November 1, 1988 (filed as Exhibit 10(c) to the 1988 Form 10-K, File No. 1-3548).

+10(v)2 - Amendments through December 2003 to the Minnesota Power and Affiliated Companies Executive Investment Plan-I.

+*10(w)1 - Executive Investment Plan-II, as amended and restated, effective November 1, 1988 (filed as Exhibit 10(d) to the 1988 Form 10-K, File No. 1-3548).

PART IV

Exhibit Number	
+10(w)2	Amendments through December 2003 to the Minnesota Power and Affiliated Companies Executive Investment Plan-II.
+*10(x)	Deferred Compensation Trust Agreement, as amended and restated, effective January 1, 1989 (filed as Exhibit 10(f) to the 1988 Form 10-K, File No. 1-3548).
+*10(y)1	Minnesota Power (now ALLETE) Executive Long-Term Incentive Compensation Plan, effective January 1, 1996 (filed as Exhibit 10(a) to the June 30, 1996 Form 10-Q, File No. 1-3548).
+*10(y)2	Amendments through January 2003 to the Minnesota Power (now ALLETE) Executive Long-Term Incentive Compensation Plan (filed as Exhibit 10(z)2 to the 2002 Form 10-K, File No. 1-3548).
+*10(z)1	Minnesota Power (now ALLETE) Director Stock Plan, effective January 1, 1995 (filed as Exhibit 10 to the March 31, 1995 Form 10-Q, File No. 1-3548).
+10(z)2	Amendments through December 2003 to the Minnesota Power (now ALLETE) Director Stock Plan.
+*10(aa)1	Minnesota Power (now ALLETE) Director Compensation Deferral Plan Amended and Restated, effective January 1, 1990 (filed as Exhibit 10(ac) to the 2002 Form 10-K, File No. 1-3548).
+10(aa)2	October 2003 Amendment to the Minnesota Power (now ALLETE) Director Compensation Deferral Plan.
12	Computation of Ratios of Earnings to Fixed Charges (Unaudited).
*21	Subsidiaries of the Registrant (reference is made to ALLETE's Form U-3A-2 for the year ended December 31, 2003, File No. 69-78).
23(a)	Consent of Independent Accountants.
23(b)	Consent of General Counsel.
31(a)	Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(b)	Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Section 1350 Certification of Annual Report by the Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Incorporated herein by reference as indicated.

\+ Management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 15(c) of Form 10-K.

(b) Reports on Form 8-K.

Report on Form 8-K filed October 15, 2003 with respect to Item 5. Other Events and Regulation FD Disclosure.

Report on Form 8-K filed October 24, 2003 with respect to Item 5. Other Events and Regulation FD Disclosure and Item 7. Financial Statements and Exhibits.

Report on Form 8-K filed October 30, 2003 with respect to Item 5. Other Events and Regulation FD Disclosure.

Report on Form 8-K filed October 31, 2003 with respect to Item 5. Other Events and Regulation FD Disclosure.

Report on Form 8-K filed November 6, 2003 with respect to Item 5. Other Events and Regulation FD Disclosure.

Report on Form 8-K filed November 13, 2003 with respect to Item 5. Other Events and Regulation FD Disclosure and Item 7. Financial Statements and Exhibits.

Report on Form 8-K filed December 5, 2003 with respect to Item 5. Other Events and Regulation FD Disclosure.

Report on Form 8-K filed January 26, 2004 with respect to Item 5. Other Events and Regulation FD Disclosure.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ALLETE, Inc.

Dated: March 11, 2004

By /s/ David G. Gartzke
David G. Gartzke
Chairman

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ David G. Gartzke David G. Gartzke	Chairman and Director	March 11, 2004
/s/ Donald J. Shippar Donald J. Shippar	President and Chief Executive Officer	March 11, 2004
/s/ James K. Vizanko James K. Vizanko	Senior Vice President, Chief Financial Officer and Treasurer	March 11, 2004
/s/ Mark A. Schober Mark A. Schober	Senior Vice President and Controller	March 11, 2004
/s/ Wynn V. Bussmann Wynn V. Bussmann	Director	March 11, 2004
/s/ Thomas L. Cunningham Thomas L. Cunningham	Director	March 11, 2004
/s/ Dennis O. Green Dennis O. Green	Director	March 11, 2004
/s/ Peter J. Johnson Peter J. Johnson	Director	March 11, 2004
/s/ George L. Mayer George L. Mayer	Director	March 11, 2004
/s/ Jack I. Rajala Jack I. Rajala	Director	March 11, 2004
/s/ Nick Smith Nick Smith	Director	March 11, 2004
/s/ Bruce W. Stender Bruce W. Stender	Director	March 11, 2004
/s/ Donald C. Wegmiller Donald C. Wegmiller	Director	March 11, 2004
/s/ Deborah L. Weinstein Deborah L. Weinstein	Director	March 11, 2004

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

To the Shareholders and
Board of Directors of ALLETE, Inc.

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of income, of cash flows and of shareholders' equity present fairly, in all material respects, the financial position of ALLETE, Inc. and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 6 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards, No. 143, "Accounting for Asset Retirement Obligations" on January 1, 2003. As discussed in Notes 2 and 9 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards, No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002.

PricewaterhouseCoopers LLP

Minneapolis, Minnesota
February 9, 2004, except as to Note 3 which is as of March 8, 2004

Report of Management

The consolidated financial statements and other financial information were prepared by management, who is responsible for their integrity and objectivity. The financial statements have been prepared in conformity with generally accepted accounting principles and necessarily include some amounts that are based on informed judgments and best estimates and assumptions of management.

To meet management's responsibilities with respect to financial information, we maintain and enforce a system of internal accounting controls designed to provide assurance, on a cost effective basis, that transactions are carried out in accordance with management's authorizations and that assets are safeguarded against loss from unauthorized use or disposition. The system includes an organizational structure that provides an appropriate segregation of responsibilities, careful selection and training of personnel, written policies and procedures, and periodic reviews by our internal audit department. In addition, we have personnel policies that require all employees to maintain a high standard of ethical conduct. Management believes the system is effective and provides reasonable assurance that all transactions are properly recorded and have been executed in accordance with management's authorization. Management modifies and improves our system of internal accounting controls in response to changes in business conditions. Our internal audit staff is charged with the responsibility for determining compliance with our procedures.

Six of our directors, not members of management, serve as the Audit Committee. Our Board of Directors, through the Audit Committee, oversees management's responsibilities for financial reporting. The Audit Committee meets regularly with management, the internal auditors and the independent auditors to discuss auditing and financial matters and to assure that each is carrying out their responsibilities. The internal auditors and the independent auditors have full and free access to the Audit Committee without management present. PricewaterhouseCoopers LLP, independent auditors, are engaged to express an opinion on the financial statements. Their audit is conducted in accordance with generally accepted auditing standards and includes a review of internal controls and tests of transactions to the extent necessary to allow them to report on the fairness of our operating results and financial condition.

David G. Gartzke
Chairman

Donald J. Shippar
President and Chief Executive Officer

James K. Vizanko
Chief Financial Officer

ALLETE Consolidated Balance Sheet

December 31	2003	2002
Millions		
Assets		
Current Assets		
Cash and Cash Equivalents	$ 223.0	$ 193.3
Trading Securities	–	1.8
Accounts Receivable — Net	403.8	383.8
Inventories	37.9	36.6
Prepayments and Other	15.8	14.1
Discontinued Operations	14.9	28.8
Total Current Assets	695.4	658.4
Property, Plant and Equipment — Net	1,499.0	1,364.7
Investments	204.6	170.9
Goodwill	511.0	502.0
Other Intangible Assets	33.3	37.6
Other Assets	70.1	67.5
Discontinued Operations	87.9	346.1
Total Assets	$3,101.3	$3,147.2
Liabilities and Shareholders' Equity		
Liabilities		
Current Liabilities		
Accounts Payable	$ 243.9	$ 202.6
Accrued Taxes, Interest and Dividends	35.2	36.4
Notes Payable	53.0	74.5
Long-Term Debt Due Within One Year	37.5	283.7
Other	107.1	111.3
Discontinued Operations	49.5	29.7
Total Current Liabilities	526.2	738.2
Long-Term Debt	747.7	696.4
Mandatorily Redeemable Preferred Securities	–	75.0
Accumulated Deferred Income Taxes	160.7	139.8
Other Liabilities	161.5	137.6
Discontinued Operations	45.0	127.8
Commitments and Contingencies		
Total Liabilities	1,641.1	1,914.8
Shareholders' Equity		
Common Stock Without Par Value, 130.0 Shares Authorized 87.3 and 85.6 Shares Outstanding	859.2	814.9
Unearned ESOP Shares	(45.4)	(49.0)
Accumulated Other Comprehensive Gain (Loss)	14.5	(22.2)
Retained Earnings	631.9	488.7
Total Shareholders' Equity	1,460.2	1,232.4
Total Liabilities and Shareholders' Equity	$3,101.3	$3,147.2

The accompanying notes are an integral part of these statements.

CONSOLIDATED FINANCIAL STATEMENTS

ALLETE Consolidated Statement of Income

For the Year Ended December 31	2003	2002	2001
Millions Except Per Share Amounts			
Operating Revenue			
Energy Services			
Regulated Utility	$ 512.8	$ 505.6	$ 538.7
Nonregulated	146.8	120.4	80.0
Automotive Services	922.3	835.8	832.1
Investments	36.9	32.5	74.8
Total Operating Revenue	1,618.8	1,494.3	1,525.6
Operating Expenses			
Fuel and Purchased Power			
Regulated Utility	212.5	206.7	233.1
Nonregulated	40.0	28.1	–
Operations			
Regulated Utility	217.7	197.0	204.1
Nonregulated	98.0	107.5	74.9
Automotive and Investments	749.0	693.4	728.3
Interest	66.6	70.5	83.0
Total Operating Expenses	1,383.8	1,303.2	1,323.4
Operating Income from Continuing Operations	235.0	191.1	202.2
Income Tax Expense	91.9	72.2	73.3
Income from Continuing Operations	143.1	118.9	128.9
Income from Discontinued Operations — Net of Tax	93.3	18.3	9.8
Net Income	$ 236.4	$ 137.2	$ 138.7
Average Shares of Common Stock			
Basic	82.8	81.1	75.8
Diluted	83.3	81.7	76.5
Earnings Per Share of Common Stock			
Basic			
Continuing Operations	$1.72	$1.47	$1.70
Discontinued Operations	1.13	0.22	0.13
	$2.85	$1.69	$1.83
Diluted			
Continuing Operations	$1.72	$1.46	$1.68
Discontinued Operations	1.12	0.22	0.13
	$2.84	$1.68	$1.81
Dividends Per Share of Common Stock	$1.13	$1.10	$1.07

The accompanying notes are an integral part of these statements.

ALLETE Consolidated Statement of Cash Flows

For the Year Ended December 31	2003	2002	2001
Millions			
Operating Activities			
Net Income	$ 236.4	$ 137.2	$ 138.7
Gain on Sale of Plant	(141.5)	–	–
Depreciation and Amortization	86.7	82.1	101.6
Deferred Income Taxes	14.3	26.9	10.3
Changes in Operating Assets and Liabilities — Net of the Effects of Acquisitions			
Trading Securities	1.8	153.8	(64.8)
Accounts Receivable	(8.8)	74.9	(82.4)
Inventories	(1.0)	(3.8)	(3.0)
Prepayments and Other	(2.5)	2.0	(9.2)
Accounts Payable	37.0	(38.0)	(23.9)
Other Current Liabilities	7.3	(7.8)	16.4
Other Assets	(2.0)	(3.9)	(8.9)
Other Liabilities	18.1	29.6	28.8
Cash from Operating Activities	245.8	453.0	103.6
Investing Activities			
Proceeds from Sale of Plant	444.7	–	–
Proceeds from Sale of Available-For-Sale Securities	7.4	1.9	2.6
Additions to Investments	(49.1)	(24.5)	(11.2)
Additions to Property, Plant and Equipment	(181.3)	(201.2)	(149.2)
Acquisitions — Net of Cash Acquired	(1.8)	(32.7)	(157.1)
Other	(7.6)	12.1	17.5
Cash from (for) Investing Activities	212.3	(244.4)	(297.4)
Financing Activities			
Issuance of Long-Term Debt	85.2	18.4	125.2
Issuance of Common Stock	44.3	43.2	189.2
Changes in Notes Payable — Net	(18.6)	(200.5)	5.5
Reductions of Long-Term Debt	(413.4)	(14.5)	(18.1)
Reductions of Mandatorily Redeemable Preferred Securities	(75.0)	–	–
Dividends on Common Stock	(93.2)	(89.2)	(81.8)
Cash from (for) Financing Activities	(470.7)	(242.6)	220.0
Effect of Exchange Rate Changes on Cash	39.2	2.7	(11.3)
Change in Cash and Cash Equivalents	26.6	(31.3)	14.9
Cash and Cash Equivalents at Beginning of Period (a)	202.9	234.2	219.3
Cash and Cash Equivalents at End of Period (a)	$ 229.5	$ 202.9	$ 234.2
Supplemental Cash Flow Information			
Cash Paid During the Period for			
Interest — Net of Capitalized	$69.2	$71.9	$84.2
Income Taxes	$87.4	$49.2	$60.5

(a) Included $6.5 million of cash from Discontinued Operations at December 31, 2003 ($9.6 million at December 31, 2002).

The accompanying notes are an integral part of these statements.

ALLETE Consolidated Statement of Shareholders' Equity

	Total Shareholders' Equity	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Common Stock
Millions					
Balance at December 31, 2000	$ 900.8	$383.8	$ (4.2)	$(55.7)	$576.9
Comprehensive Income					
Net Income	138.7	138.7			
Other Comprehensive Income — Net of Tax					
Unrealized Gains on Securities — Net	2.5		2.5		
Interest Rate Swap	(1.5)		(1.5)		
Foreign Currency Translation Adjustments	(11.3)		(11.3)		
Total Comprehensive Income	128.4				
Common Stock Issued — Net	193.4				193.4
Dividends Declared	(81.8)	(81.8)			
ESOP Shares Earned	3.0			3.0	
Balance at December 31, 2001	1,143.8	440.7	(14.5)	(52.7)	770.3
Comprehensive Income					
Net Income	137.2	137.2			
Other Comprehensive Income — Net of Tax					
Unrealized Gains on Securities — Net	(8.1)		(8.1)		
Interest Rate Swap	1.3		1.3		
Foreign Currency Translation Adjustments	2.6		2.6		
Additional Pension Liability	(3.5)		(3.5)		
Total Comprehensive Income	129.5				
Common Stock Issued — Net	44.6				44.6
Dividends Declared	(89.2)	(89.2)			
ESOP Shares Earned	3.7			3.7	
Balance at December 31, 2002	1,232.4	488.7	(22.2)	(49.0)	814.9
Comprehensive Income					
Net Income	236.4	236.4			
Other Comprehensive Income — Net of Tax					
Unrealized Gains on Securities — Net	3.6		3.6		
Interest Rate Swap	0.2		0.2		
Foreign Currency Translation Adjustments	39.2		39.2		
Additional Pension Liability	(6.3)		(6.3)		
Total Comprehensive Income	273.1				
Common Stock Issued — Net	44.3				44.3
Dividends Declared	(93.2)	(93.2)			
ESOP Shares Earned	3.6			3.6	
Balance at December 31, 2003	$1,460.2	$631.9	$ 14.5	$(45.4)	$859.2

The accompanying notes are an integral part of these statements.

1 Business Segments

Business Segments

For the Year Ended December 31	Consolidated	Energy Services	Automotive Services	Investments and Corporate Charges
Millions				
2003				
Operating Revenue	$1,618.8	$659.6	$922.3 (c)	$ 36.9
Operation and Other Expense	1,230.7	517.1	681.4	32.2
Depreciation and Amortization Expense	86.5	51.1	35.3	0.1
Interest Expense	66.6	22.4	16.0	28.2
Operating Income (Loss) from Continuing Operations	235.0	69.0	189.6	(23.6)
Income Tax Expense (Benefit)	91.9	26.6	74.8	(9.5)
Income (Loss) from Continuing Operations	143.1	42.4	114.8	(14.1)
Income from Discontinued Operations — Net of Tax	93.3 (a)	–	0.3	–
Net Income	$ 236.4 (a)	$ 42.4	$115.1	$(14.1)
Total Assets	$3,101.3 (b)	$1,213.3	$1,632.7 (d)	$152.5
Capital Expenditures	$136.3 (b)	$73.6	$26.9	–
2002				
Operating Revenue	$1,494.3	$626.0	$835.8 (c)	$ 32.5
Operation and Other Expense	1,151.0	490.5	627.7	32.8
Depreciation and Amortization Expense	81.7	48.8	32.8	0.1
Interest Expense	70.5	21.2	21.2	28.1
Operating Income (Loss) from Continuing Operations	191.1	65.5	154.1	(28.5)
Income Tax Expense (Benefit)	72.2	23.7	59.9	(11.4)
Income (Loss) from Continuing Operations	118.9	41.8	94.2	(17.1)
Income (Loss) from Discontinued Operations — Net of Tax	18.3 (a)	(1.2)	(5.9)	–
Net Income	$ 137.2 (a)	$ 40.6	$ 88.3	$(17.1)
Total Assets	$3,147.2 (b)	$1,150.9	$1,471.1 (d)	$150.3
Capital Expenditures	$201.2 (b)	$80.9	$66.5	$5.7
2001				
Operating Revenue	$1,525.6	$618.7	$832.1 (c)	$74.8
Operation and Other Expense	1,151.5	466.2	635.1	50.2
Depreciation and Amortization Expense	88.9	45.9	42.7	0.3
Interest Expense	83.0	22.5	35.3	25.2
Operating Income (Loss) from Continuing Operations	202.2	84.1	119.0	(0.9)
Income Tax Expense (Benefit)	73.3	32.4	44.2	(3.3)
Income from Continuing Operations	128.9	51.7	74.8	2.4
Income (Loss) from Discontinued Operations — Net of Tax	9.8 (a)	(1.6)	(7.0)	–
Net Income	$ 138.7 (a)	$ 50.1	$ 67.8	$ 2.4
Total Assets	$3,282.5 (b)	$1,049.1	$1,515.4 (d)	$365.5
Capital Expenditures	$149.2 (b)	$59.9	$57.2	–

(a) Included $93.0 million of income from Water Services businesses ($25.4 million in 2002; $18.4 million in 2001).
(b) Discontinued operations represented $102.8 million of total assets in 2003 ($374.9 million in 2002; $352.5 million in 2001) and $35.8 million of capital expenditures in 2003 ($48.1 million in 2002; $32.1 million in 2001).
(c) Included $173.1 million of Canadian operating revenue in 2003 ($141.9 million in 2002; $139.4 million in 2001).
(d) Included $220.1 million of Canadian assets in 2003 ($184.7 million in 2002; $187.6 million in 2001).

2 Operations and Significant Accounting Policies

Financial Statement Preparation. References in this report to "we," "us" and "our" are to ALLETE and its subsidiaries, collectively. We prepare our financial statements in conformity with generally accepted accounting principles. These principles require management to make informed judgments, best estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results could differ from those estimates.

Principles of Consolidation. Our consolidated financial statements include the accounts of ALLETE and all of our majority owned subsidiary companies. All material intercompany balances and transactions have been eliminated in consolidation. Information for prior periods has been reclassified to present comparable information for all periods.

Business Segments. Energy Services and Automotive Services segments were determined based on products and services provided. The Investment and Corporate Charges segment was determined based on short-term corporate liquidity needs and the need to provide financial flexibility to pursue strategic initiatives in the other business segments. We measure performance of our operations through careful budgeting and monitoring of contributions to consolidated net income by each business segment. Discontinued Operations included financial results of our Water Services businesses, our vehicle transport and import businesses, and our retail stores.

Energy Services. Energy Services is engaged in the generation, transmission, distribution and marketing of electricity, as well as coal mining and telecommunications.

Minnesota Power, an operating division of ALLETE, and SWL&P, a wholly owned subsidiary, provide regulated utility electric service to 149,000 retail customers in northeastern Minnesota and northwestern Wisconsin. Approximately 50% of regulated utility electric sales are to large power customers (which consists of five taconite producers, four paper and pulp mills, two pipeline companies and one manufacturer) under all-requirements contracts with expiration dates extending from March 2005 through April 2009. Regulated utility electric rates are under the jurisdiction of various state and federal regulatory authorities. Billings are rendered on a cycle basis. Revenue is accrued for service provided but not billed. Regulated utility electric rates include adjustment clauses that bill or credit customers for fuel and purchased energy costs above or below the base levels in rate schedules and that bill retail customers for the recovery of CIP expenditures not collected in base rates.

Minnesota Power and wholly owned subsidiary Rainy River Energy, through its Kendall County power purchase agreement, also engage in nonregulated electric generation and power marketing. Nonregulated generation is non-rate base generation sold at market-based rates to the wholesale market.

BNI Coal, a wholly owned subsidiary, mines and sells lignite coal to two North Dakota mine-mouth generating units, one of which is Square Butte. Square Butte supplies approximately 71% (323 MW) of its output to Minnesota Power under a long-term contract. (See Note 15.)

Enventis Telecom, a wholly owned subsidiary, is our telecommunications business which is an integrated data services provider offering fiber optic-based communication and advanced data services to businesses and communities in Minnesota, Wisconsin and Missouri.

Split Rock Energy is a joint venture between Minnesota Power and Great River Energy from which we are withdrawing. Split Rock Energy was formed to combine power supply capabilities and customer loads for power pool operations and generation outage protection. In response to the changing strategies of both parties, as of February 2004 we withdrew from active participation in Split Rock Energy and will terminate our ownership interest upon receipt of FERC approval which is expected in the first half of 2004. We have retained some of the benefits of the partnership, such as joint load and capability reporting. As a result of withdrawing from active participation, we received a $10.0 million distribution in February 2004 representing the majority of our capital account balance on the date of withdrawal. The remaining balance in our capital account will be distributed upon FERC approval. Prior to withdrawing from active participation, we accounted for our 50% ownership interest in Split Rock Energy under the equity method of accounting. For the year ended December 31, 2003 our pre-tax equity income from Split Rock Energy was $2.9 million ($7.3 million in 2002; $3.6 million in 2001). We did not receive any cash distributions from Split Rock Energy in 2003 ($2.6 million in 2002; $2.1 million in 2001). We purchased power from Split Rock Energy to serve native load requirements and sold generation to Split Rock Energy. Purchases and sales were at market rates. In 2003 we made power purchases from Split Rock Energy of $50.9 million ($34.3 million in 2002; $56.1 million in 2001) and power sales to Split Rock Energy of $19.6 million ($14.5 million in 2002; $13.3 million in 2001).

Automotive Services. Automotive Services operates (through several wholly owned subsidiaries) two main businesses that are integral parts of the vehicle redistribution industry: auctions and related services, and dealer financing.

We are a service provider and do not actually buy and sell vehicles. We provide auction, reconditioning, logistics, and other administrative outsourcing services to wholesale vehicle buyers and sellers for a fee. Buyers are licensed franchised, independent and wholesale used vehicle dealers, while sellers include vehicle manufacturers, dealers, automotive fleet/lease companies, credit unions and other financial institutions, finance companies and rental car companies. We also provide floorplan financing.

Revenue is recognized when the services we provide are performed. Revenue includes the Company's fees for such services and interest earned on floorplan receivables. We do not report the gross sales price of the vehicles in revenue nor the related purchase price in operating expense.

Wholesale vehicle auctions include 53 used vehicle auctions, 27 salvage vehicle auctions and other related services. Used vehicles are sold to dealers through our used vehicle auctions, and salvage vehicle services are provided primarily to insurance companies through our salvage auctions. Other related services include inbound and outbound logistics, reconditioning, vehicle inspection and certification, and titling services.

Dealer financing consists of AFC which provides short-term inventory-secured financing for used vehicle dealers who purchase vehicles at auctions. AFC has 80 loan production offices located across North America. These offices provide qualified dealers credit to purchase vehicles at any of the 500 plus auctions and other outside sources approved by AFC.

AFC's revenue is comprised of gains on sales of receivables, and interest and fee income. Revenue from AFC was $104.0 million in 2003 ($98.6 million in 2002; $91.7 million in 2001). As is customary for finance companies, AFC's revenue is reported net of interest expense of $0.3 million in 2003 ($1.3 million in 2002; $3.4 million in 2001) and is included in Operating Revenue – Automotive Services on our consolidated statement of income. Interest on finance receivables is recognized based on the number of days the vehicle remains financed. AFC generally sells its United States dollar denominated finance receivables through a private securitization structure. Gains and losses on such sales are generally recognized at the time of settlement based on the difference between the sales proceeds and the allocated basis of the finance receivables sold, adjusted for transaction fees.

Investments and Corporate Charges. Investments and Corporate Charges include real estate operations, investments in emerging technologies related to the electric utility industry and general corporate expenses, including interest, not specifically related to any one business segment. Our real estate operations include several wholly owned subsidiaries and an 80% ownership in Lehigh which are consolidated in ALLETE's financial statements. All are Florida real estate companies principally engaged in real estate acquisition, sales and investment activities. Full profit recognition is recorded on sales upon closing provided cash collections are at least 20% of the contract price and the other requirements of GAAP concerning profit recognition are met.

Investments and Corporate Charges included Operation and Other Expense totaling $17.6 million in 2003 ($16.5 million in 2002; $22.8 million in 2001) for general corporate expenses such as employee salaries and benefits, and legal and other outside contract service fees, and Interest Expense of $28.0 million in 2003 ($28.1 million in 2002; $25.2 million in 2001). Also included in Investments and Corporate Charges was our trading securities portfolio which was liquidated during the second half of 2002.

Property, Plant and Equipment. Property, plant and equipment are recorded at original cost and are reported on the balance sheet net of accumulated depreciation. Expenditures for additions and significant replacements and improvements are capitalized; maintenance and repair costs are expensed as incurred. Expenditures for major plant overhauls are also accounted for using this same policy. Gains or losses on nonregulated property, plant and equipment are recognized when they are retired or otherwise disposed of. When regulated utility property, plant and equipment are retired or otherwise disposed of, no gain or loss is recognized.

Long-Lived Asset Impairments. We periodically review our long-lived assets whenever events indicate the carrying amount of the assets may not be recoverable. Excluding impairment losses recorded on certain remaining water assets held for sale, as of December 31, 2003 no write-downs were required.

Accounts Receivable. Accounts receivable are reported on the balance sheet net of an allowance for doubtful accounts. The allowance is based on our evaluation of the receivable portfolio under current conditions, the size of the portfolio, overall portfolio quality, review of specific problems and such other factors that in our judgment deserve recognition in estimating losses.

Accounts Receivable

December 31	2003	2002
Millions		
Trade Accounts Receivable	$224.2	$214.9
Less: Allowance for Doubtful Accounts	8.4	8.8
	215.8	206.1
Finance Receivables		
AFC — Net	187.0	177.3
Real Estate — Net	1.0	0.4
	188.0	177.7
Total Accounts Receivable — Net	$403.8	$383.8

AFC sells the majority of United States dollar denominated finance receivables on a revolving basis to a wholly owned, bankruptcy remote, special purpose subsidiary that is consolidated for accounting purposes. The special purpose subsidiary has entered into a securitization agreement, which expires in 2005, that allows for the revolving sale to a bank conduit facility of up to a maximum of $500 million in undivided interests in eligible finance receivables. The outstanding receivables sold and a cash reserve equal to 1% of total receivables sold serve as security interest for the receivables that have been sold to the bank conduit facility.

Finance Receivables Managed by AFC

At December 31	Total	Delinquent (a)
Millions		
2003		
Finance Receivables Managed	$538.8	$7.8
Less: Amounts Sold to Bank Facility	333.8	
Gross Finance Receivables Recognized	205.0	
Less: Allowance for Doubtful Accounts	18.0	
Net Finance Receivables Recognized	$187.0	
2002		
Finance Receivables Managed	$501.1	$8.0
Less: Amounts Sold to Bank Facility	303.8	
Gross Finance Receivables Recognized	197.3	
Less: Allowance for Doubtful Accounts	20.0	
Net Finance Receivables Recognized	$177.3	

For the Year Ended December 31	2003	2002
Millions		
Net Credit Losses from Total Receivables Managed	$14.2	$14.7
Total Proceeds from Sales of Finance Receivables	$4,134.3	$4,142.3

(a) Defined as 60 days or more past due.

AFC's proceeds from the revolving sale of receivables to the bank conduit facility were used to repay borrowings from ALLETE and fund new loans to customers. AFC and the special purpose subsidiary must maintain certain financial covenants such as minimum tangible net worth to comply with the terms of the securitization agreement. AFC has historically performed better than the covenant thresholds set forth in the securitization agreement, and we are not aware of any changing circumstances that would put AFC in noncompliance with the covenants.

Inventories. Inventories, which include fuel, material and supplies, are stated at the lower of cost or market. Cost is determined by the average cost method.

Goodwill. All goodwill relates to the Automotive Services segment and represents the excess of cost over identifiable tangible and intangible net assets of businesses acquired. As required by SFAS 142, "Goodwill and Other Intangible Assets," goodwill is no longer amortized after 2001. Prior to 2002 we amortized goodwill on a straight-line basis over 40 years.

Unamortized Expense, Discount and Premium on Debt. Expense, discount and premium on debt are deferred and amortized over the lives of the related issues.

Cash and Cash Equivalents. We consider all investments purchased with maturities of three months or less to be cash equivalents.

Accounting for Stock-Based Compensation. We have elected to account for stock-based compensation in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, we recognize expense for performance share awards granted and do not recognize expense for employee stock options granted. The after-tax expense recognized for performance share awards was approximately $3 million in 2003 ($4 million in 2002). The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123, "Accounting for Stock-Based Compensation."

For the Year Ended December 31	2003	2002	2001
Millions Except Per Share Amounts			
Net Income			
As Reported	$236.4	$137.2	$138.7
Less: Employee Stock Compensation Expense Determined Under SFAS 123 — Net of Tax	(0.5)	(1.4)	0.8
Pro Forma Net Income	$235.9	$135.8	$139.5
Basic Earnings Per Share			
As Reported	$2.85	$1.69	$1.83
Pro Forma	$2.85	$1.67	$1.84
Diluted Earnings Per Share			
As Reported	$2.84	$1.68	$1.81
Pro Forma	$2.83	$1.66	$1.82

In the previous table, the expense for employee stock options granted determined under SFAS 123 was calculated using the Black-Scholes option pricing model and the following assumptions:

	2003	2002	2001
Risk-Free Interest Rate	3.1%	4.4%	5.0%
Expected Life — Years	5	5	5
Expected Volatility	25.2%	24.2%	22.2%
Dividend Growth Rate	2%	2%	2%

Foreign Currency Translation. Results of operations for our Canadian and Mexican subsidiaries are translated into United States dollars using the average exchange rates during the period. Assets and liabilities are translated into United States dollars using the exchange rate on the balance sheet date. Resulting translation adjustments are recorded in the Accumulated Other Comprehensive Gain (Loss) section of Shareholders' Equity on our consolidated balance sheet.

Environmental Liabilities. 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. These accruals are adjusted periodically as assessment and remediation efforts progress or as additional technical or legal information becomes available. Accruals for environmental liabilities are included in the balance sheet at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. Costs related to environmental contamination treatment and cleanup are charged to expense.

Income Taxes. We file a consolidated federal income tax return. Income taxes are allocated to each subsidiary based on their taxable income. We account for income taxes using the liability method as prescribed by SFAS 109, "Accounting for Income Taxes." Under the liability method, deferred income tax liabilities are established for all temporary differences in the book and tax basis of assets and liabilities based upon enacted tax laws and rates applicable to the periods in which the taxes become payable. Due to the effects of regulation on Minnesota Power, certain adjustments made to deferred income taxes are, in turn, recorded as regulatory assets or liabilities. Investment tax credits have been recorded as deferred credits and are being amortized to income tax expense over the service lives of the related property.

Excise Taxes. We collect an immaterial amount of excise taxes from our customers levied by government entities. These taxes are stated separately on the billing to the customer and recorded as a liability to be remitted to the government entity. We account for the collection and payment of these taxes on the net basis and neither the amounts collected or paid are reflected on our consolidated statement of income.

New Accounting Standards. In January 2004 the FASB issued FASB Staff Position SFAS 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (Act). This Staff Position allows employers who sponsor a postretirement health plan that provides prescription drug benefits to defer recognizing the effects of the Act in accounting for its plan under SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" until authoritative accounting guidance is issued. We provide postretirement health benefits that include prescription drug benefits, and in accordance with this Staff Position, have elected not to reflect the impact of the Act in our 2003 financial statements. We expect the Act will eventually reduce our costs for postretirement health benefits and are reviewing the impact on our accumulated plan benefit obligation and expense going forward.

In May 2003 the FASB issued SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." In general, SFAS 150 established standards for classification and measurement of certain financial instruments with the characteristics of both liabilities and equity. Mandatorily redeemable financial instruments must be classified as a liability and the related payments must be reported as interest expense. The new rules became effective in the third quarter of 2003 for previously existing financial instruments. Beginning with the third quarter of 2003, we reclassified our Mandatorily Redeemable Preferred Securities as a long-term liability and reclassified the quarterly distributions as interest expense. This was a reclassification only and did not impact our results of operations. The Mandatorily Redeemable Preferred Securities were redeemed in December 2003.

In January 2003 the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." In general, a variable interest entity is one with equity investors that do not have voting rights or do not provide sufficient financial resources for the entity to support its activities. Under the new rules, variable interest entities are consolidated by the party that is subject to the majority of the risk of loss or entitled to the majority of the residual returns. In December 2003 the FASB issued Interpretation No. 46R to replace and clarify some of the provisions of Interpretation No. 46. Under Interpretation 46R, the rules became effective on December 15, 2003 for interest in certain structures, and March 15, 2004 for interest in all other structures. We are not a party to any variable interest entity required to be consolidated under Interpretation No. 46R.

3 Spin-off and IPO of Automotive Services

In October 2003 our Board of Directors approved a plan to spin off to ALLETE shareholders our Automotive Services business which will become a publicly traded company doing business as ADESA. The spin-off is expected to take the form of a tax-free stock dividend to ALLETE's shareholders, who would receive one ADESA share for each share of ALLETE stock they own. The spin-off is subject to the approval of the final plan by ALLETE's Board of Directors, favorable market conditions, receipt of tax opinions, satisfaction of SEC requirements and other customary conditions, and is expected to occur in the third quarter of 2004. In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we will report the Automotive Services business in discontinued operations after the spin-off.

In March 2004 our Board of Directors approved an initial public offering (IPO) of approximately $150 million in common shares of ADESA, representing less than 20% of all ADESA common stock outstanding. A registration statement was filed with the SEC in March 2004, with the sale of ADESA stock expected to take place as soon as practical after the registration statement becomes effective. Subsequent to the IPO, ALLETE will continue to own and consolidate the remaining portion of ADESA until consummation of the spin-off.

4 Discontinued Operations

In 2002 we began to execute plans developed in a strategic review of all our businesses to unlock shareholder value not reflected in the price of our common stock. Businesses identified as having more value if operated by potential purchasers rather than by us include our Water Services businesses in Florida, which were under imminent threats of condemnation, North Carolina and Georgia, and our vehicle transport business. We sold our vehicle transport business and exited our retail stores at the end of first quarter 2002, and exited our vehicle import business in the first quarter of 2003.

The December 2002 asset purchase agreement Florida Water signed with the Florida Water Services Authority, a governmental authority formed under the laws of the state of Florida, was terminated by Florida Water in March 2003 after a Florida court ruling delayed the sale. Selling costs associated with this terminated transaction were expensed in 2003 and are included in Gain (Loss) on Disposal in the following table.

During 2003, we sold, under condemnation or imminent threat of condemnation, substantially all of our water assets in Florida for a total sales price of approximately $445 million. In addition, we reached an agreement to sell our North Carolina water assets for $48 million and the assumption of approximately $28 million in debt by the purchaser. The North Carolina sale is awaiting approval of the NCUC and is expected to close in mid-2004. We expect to sell our remaining water assets in Florida and Georgia in 2004.

Earnings from Discontinued Operations for 2003 included a $71.6 million, or $0.86 per share, after-tax gain on the sale of substantially all our Water Services businesses. The gain was net of all selling, transaction and employee termination benefit expenses, as well as impairment losses on certain remaining assets. In accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we recorded an impairment loss on certain remaining water assets where the fair value, less costs to sell, was less than our carrying amount.

The net cash proceeds from the sale of all water assets, after transaction costs, retirement of most Florida Water debt and payment of income taxes, are expected to be approximately $300 million. These net proceeds have been, and will be, used to retire debt at ALLETE.

Summary of Discontinued Operations

Millions

Income Statement

Year Ended December 31	2003	2002	2001
Operating Revenue	$109.2	$134.0	$149.3
Pre-Tax Income from Operations	$ 32.8	$36.9	$23.8
Income Tax Expense	12.4	14.7	9.6
	20.4	22.2	14.2
Gain (Loss) on Disposal	112.1 (a)	(5.8)	(6.8)
Income Tax Expense (Benefit)	39.2	(1.9)	(2.4)
	72.9	(3.9)	(4.4)
Income from Discontinued Operations	$ 93.3	$18.3	$ 9.8

(a) Included a $2.0 million recovery from a settlement related to the 2002 sale of our vehicle transport business.

Balance Sheet Information

December 31	2003	2002
Assets of Discontinued Operations		
Cash and Cash Equivalents	$ 6.5	$ 9.6
Other Current Assets	8.4	19.2
Property, Plant and Equipment	81.2	311.6
Other Assets	6.7	34.5
	$102.8	$374.9
Liabilities of Discontinued Operations		
Current Liabilities	$49.5	$ 29.7
Long-Term Debt	19.9	90.7
Other Liabilities	25.1	37.1
	$94.5	$157.5

In October 2003 the FPSC voted to initiate a proceeding to examine whether the sale of Florida Water's assets involves a gain that should be shared with Florida Water's customers. The question raised is whether the entire gain from the asset sales should go to Florida Water and its shareholders, or should it be shared with customers. In November 2003 the FPSC issued a final order regarding a similar gain on sale issue for Utilities, Inc. In that order the FPSC made several findings that could be helpful to Florida Water's case including among others; that courts have found that rates paid by customers do not vest ratepayers with ownership rights to the property used to render service, and shareholders bear the risk of gain or loss associated with investments made to provide service. Florida Water intends to vigorously contest any decision to seek sharing of the gain with customers. Florida Water is unable to predict the outcome of this proceeding.

5 Acquisitions

ADESA Auction Facilities. In January 2001 we acquired all of the outstanding stock of ComSearch in exchange for ALLETE common stock and paid cash to purchase all of the assets of Auto Placement Center (now ADESA Impact) in transactions with an aggregate value of $62.4 million. In May 2001 ADESA purchased the assets of the I-44 Auto Auction in Tulsa, Oklahoma. ADESA Impact and ADESA Tulsa were accounted for using the purchase method and financial results have been included in our consolidated financial statements since the date of purchase. Pro forma financial results were not material. ComSearch was accounted for as a pooling of interests. Financial results for prior periods have not been restated to reflect this pooling due to immateriality.

Acquisition of Enventis, Inc. In July 2001 we acquired Enventis, Inc., a data network systems provider headquartered in the Minneapolis-St. Paul area. In connection with this acquisition, we issued 310,878 shares of ALLETE common stock. Enventis was accounted for as a pooling of interests. Financial results for prior periods have not been restated to reflect this pooling due to immateriality.

Acquisition of Generating Facility. In October 2001 we acquired certain non-mining properties from LTV and Cleveland-Cliffs Inc. for $75 million. The non-mining properties included a 200 MW nonregulated electric generating facility located at Taconite Harbor in northeastern Minnesota.

Real Estate Acquisitions. In December 2002 our real estate subsidiary purchased additional land near Palm Coast, Florida. The transaction was accounted for using the purchase method.

In September 2001 our real estate subsidiary purchased Winter Haven Citi Centre, a retail shopping center. In December 2001 and January 2002 real estate subsidiaries purchased additional land in Palm Coast, Florida. These transactions had a combined purchase price of approximately $31 million and were accounted for using the purchase method.

6 Property, Plant and Equipment

Property, Plant and Equipment

For the Year Ended December 31	2003	2002
Millions		
Energy Services Regulated Utility	$1,475.7	$1,433.1
Construction Work in Progress	11.9	13.3
Accumulated Depreciation	(692.3)	(679.5)
Energy Services Regulated Utility Plant — Net	795.3	766.9
Energy Services Nonregulated	161.2	153.4
Construction Work in Progress	1.6	4.1
Accumulated Depreciation	(42.8)	(48.0)
Energy Services Nonregulated Plant — Net	120.0	109.5
Automotive Services	680.5	525.2
Construction Work in Progress	2.8	38.5
Accumulated Depreciation	(103.6)	(79.5)
Automotive Services Plant — Net	579.7	484.2
Other Plant — Net	4.0	4.1
Property, Plant and Equipment — Net	$1,499.0	$1,364.7

Depreciation is computed using the straight-line method over the estimated useful lives of the various classes of plant. The MPUC and the PSCW have approved depreciation rates for our Energy Services utility plant.

Estimated Useful Lives of Property, Plant and Equipment

Energy Services Regulated Utility	
Generation	5 to 30 years
Transmission	40 to 60 years
Distribution	30 to 70 years
Energy Services Nonregulated	5 to 35 years
Automotive Services	
Building and Improvements	5 to 40 years
Other	2 to 10 years

Asset Retirement Obligations. Effective January 1, 2003 we adopted SFAS 143, "Accounting for Asset Retirement Obligations." Under the new accounting standard, we recognize, at fair value, obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction or development and/or normal operation of the asset. The associated retirement costs are capitalized as part of the related long-lived asset and depreciated over the useful life of the asset. Asset retirement obligations relate primarily to the decommissioning of our utility steam generating facilities and reclamation at BNI Coal, and are included in Other Liabilities on our consolidated balance sheet. Prior to the adoption of SFAS 143, utility decommissioning obligations were accrued through depreciation expense at depreciation rates approved by the MPUC. Upon implementation of SFAS 143, we reclassified previously recorded liabilities of $12.5 million from Accumulated Depreciation and capitalized a net asset retirement cost of $6.7 million.

Asset Retirement Obligation

Millions	
Obligation at December 31, 2002	–
Initial Obligation Upon Adoption of SFAS 143	$19.0
Accretion Expense	0.7
Additional Liabilities Incurred in 2003	1.0
Obligation at December 31, 2003	$20.7

7 Regulatory Matters

We file for periodic rate revisions with the MPUC, the FERC and other state regulatory authorities. Interim rates in Minnesota are placed into effect, subject to refund with interest, pending a final decision by the appropriate commission. In 2003, 29% of our consolidated operating revenue (32% in 2002; 31% in 2001) was under regulatory authority. The MPUC had regulatory authority over approximately 23% in 2003 (25% in 2002 and 2001) of our consolidated operating revenue.

Electric Rates. New federal legislation and FERC regulations have been proposed that aim to maintain reliability, assure adequate energy supply, and address wholesale price volatility while encouraging wholesale competition. Legislation or regulation that initiates a process which may lead to retail customer choice of their electric service provider currently lacks momentum in both Minnesota and Wisconsin. Legislative and regulatory activity as well as the actions of competitors affect the way Minnesota Power strategically plans for its future. We cannot predict the timing or substance of any future legislation or regulation.

Deferred Regulatory Charges and Credits. Our regulated utility operations are subject to the provisions of SFAS 71, "Accounting for the Effects of Certain Types of Regulation." We capitalize as deferred regulatory charges incurred costs which are probable of recovery in future utility rates. Deferred regulatory credits represent amounts expected to be credited to customers in rates. Deferred regulatory charges and credits are included in other assets and other liabilities on our consolidated balance sheet.

Deferred Regulatory Charges and Credits

December 31	2003	2002
Millions		
Deferred Charges		
Income Taxes	$ 14.1	$ 11.8
Conservation Improvement Programs	1.5	0.1
Premium on Reacquired Debt	3.8	3.9
Other	6.8	4.2
	26.2	20.0
Deferred Credits — Income Taxes	39.3	39.5
Net Deferred Regulatory Liabilities	$(13.1)	$(19.5)

8 Financial Instruments

Securities Investments. At December 31, 2003 Investments included securities accounted for as available-for-sale under SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities," and securities in our emerging technology portfolio accounted for under the cost method. Investment gains and losses were included in Operating Revenue – Investments on our consolidated income statement.

At December 31, 2003 our available-for-sale securities portfolio consisted of securities in a grantor trust established to fund certain employee benefits. Available-for-sale securities are recorded at fair value with unrealized gains and losses included in accumulated other comprehensive income, net of tax. Unrealized losses that are other than temporary are recognized in earnings. We use the specific identification method as the basis for determining the cost of securities sold. Our policy is to review on a quarterly basis available-for-sale securities for other than temporary impairment by assessing such factors as the continued viability of products offered, cash flow, share price trends and the impact of overall market conditions. As a result of our periodic assessments, we did not record any impairment write-down on available-for-sale securities in 2003 or 2002. During the second quarter of 2003 we sold the publicly-traded investments held in our emerging technology portfolio and recognized a $2.3 million after-tax loss. These publicly-traded emerging technology investments were accounted for as available-for-sale securities prior to sale.

Available-For-Sale Securities

Millions

At December 31	Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Fair Value
2003	$18.8	$1.4	–	$20.2
2002	$25.4	$0.7	$(5.2)	$20.9
2001	$18.1	$10.3	$(1.9)	$26.5

Year Ended December 31	Sales Proceeds	Gross Realized Gain	Gross Realized (Loss)	Net Unrealized Gain (Loss) in Other Comprehensive Income
2003	$6.4	$1.2	$(4.7)	$2.4
2002	$12.1	$1.0	–	$(11.8)
2001	–	–	–	$3.6

As part of our emerging technology portfolio, we have several minority investments in venture capital funds and privately-held start-up companies. The total carrying value of these investments was $37.5 million at December 31, 2003 ($38.7 million at December 31, 2002). Our policy is to quarterly review these investments for impairment by assessing such factors as continued commercial viability of products, cash flow and earnings. Any impairment would reduce the carrying value of the investment. We did not record any impairment loss on these investments in 2003 ($1.5 million pretax in 2002; $0.2 million pretax in 2001).

During the second half of 2002 we substantially liquidated our trading securities portfolio and incurred a $2.9 million after-tax loss. Prior to liquidation, the trading securities portfolio consisted primarily of the common stock of various publicly traded companies and was included in current assets at fair value. Changes in fair value were recognized in earnings, and the net unrealized gain included in 2001 income was $0.9 million.

Financial Instruments and Off-Balance Sheet Risks. In October 2001 we entered into an interest rate swap agreement which expired in January 2003. We have not entered into any new interest rate swap agreements.

Fair Value of Financial Instruments. With the exception of the items listed below, the estimated fair values of all financial instruments approximate the carrying amount. The fair values for the items below were based on quoted market prices for the same or similar instruments.

Financial Instruments

December 31	Carrying Amount	Fair Value
Millions		
Long-Term Debt		
2003	$785.2	$835.8
2002	$980.1	$1,027.7
Quarterly Income Preferred Securities		
2003	–	–
2002	$75.0	$75.5

Concentration of Credit Risk. Financial instruments that subject us to concentrations of credit risk consist primarily of accounts receivable. Minnesota Power sells electricity to about 13 customers in northern Minnesota's taconite, pipeline, paper and wood products industries. Receivables from these customers totaled approximately $8 million at December 31, 2003 ($10 million at December 31, 2002). Minnesota Power does not obtain collateral to support utility receivables, but monitors the credit standing of major customers.

Due to the nature of our Automotive Services' business, substantially all trade and finance receivables are due from vehicle dealers and insurance companies. We have possession of vehicles or vehicle titles collateralizing a significant portion of the trade and finance receivables.

9 Goodwill and Other Intangibles

The table below sets forth what reported net income and earnings per share would have been exclusive of amortization expense recognized related to goodwill or other intangible assets that are no longer being amortized. Goodwill is no longer amortized after 2001. All goodwill amortization related to continuing operations.

	2001
Millions Except Per Share Amounts	
Net Income	
Reported	$138.7
Goodwill Amortization	9.9
Adjusted	$148.6
Earnings Per Share	
Basic	
Reported	$1.83
Goodwill Amortization	0.13
Adjusted	$1.96
Diluted	
Reported	$1.81
Goodwill Amortization	0.13
Adjusted	$1.94

We conduct our annual goodwill impairment testing in the second quarter of each year and the 2003 test resulted in no impairment. No event or change has occurred that would indicate the carrying amount has been impaired since our annual test.

Goodwill

Millions	
Carrying Value, December 31, 2001	$491.9
Acquired During Year	10.1
Carrying Value, December 31, 2002	502.0
Acquired During Year	0.8
Change Due to Foreign Currency Adjustment	8.2
Carrying Value, December 31, 2003	$511.0

Other Intangible Assets

December 31	2003	2002
Millions		
Customer Relationships	$ 29.6	$ 29.6
Computer Software	28.1	32.6
Other	5.7	6.7
Accumulated Amortization	(30.1)	(31.3)
Total	$ 33.3	$ 37.6

Other Intangible Assets are amortized using the straight-line method. Amortization periods are three to fifty years for Customer Relationships, one to seven years for Computer Software and three to ten years for Other. Total amortization expense for Other Intangible Assets was $9.0 million in 2003 ($10.2 million in 2002; $9.5 million in 2001) and is expected to be about $4 million to $8 million over the next five years.

Costs incurred related to computer software developed or purchased for internal use are capitalized during the application development stage of software development. Included in total amortization expense for Other Intangible Assets was $5.2 million related to computer software ($6.0 million in 2002; $4.0 million in 2001).

10 Short-Term Borrowings and Compensating Balances

We have bank lines of credit aggregating $196.5 million ($217.0 million at December 31, 2002), the majority of which expire in December 2004 and are negotiated on an annual basis. These bank lines of credit make financing available through short-term bank loans and provide credit support for commercial paper. At December 31, 2003, $196.5 million was available for use ($216.3 million at December 31, 2002). There was no commercial paper issued as of December 31, 2003 ($73.8 million in 2002 with a weighted average interest rate of 1.79%).

Certain lines of credit require a commitment fee of 0.0150%. Interest rates on short-term borrowings were 2.06% at December 31, 2003 (1.75% to 1.85% at December 31, 2002). The total amount of compensating balances at December 31, 2003 and 2002, was immaterial.

In July 2003 ALLETE entered into a credit agreement to borrow $250 million from a consortium of financial institutions, the proceeds of which were used to redeem $250 million of the Company's Floating Rate First Mortgage Bonds due October 20, 2003. The credit agreement expires in July 2004, has an interest rate of LIBOR plus 0.875% and is secured by the lien of the Company's Mortgage and Deed of Trust. The credit agreement also has certain mandatory prepayment provisions, including a requirement to repay an amount equal to 75% of the net proceeds from the sale of water assets. In accordance with these provisions $197.0 million was repaid in 2003 and $53.0 million was outstanding at December 31, 2003.

Our lines of credit contain financial covenants. These covenants require ALLETE (1) not to exceed a maximum ratio of funded debt to total capital of .60 to 1.0 and (2) to maintain an interest coverage ratio of not less than 3.00 to 1.00. Failure to meet these covenants could give rise to an event of default, if not corrected after notice from the lender; in which event ALLETE may need to pursue alternative sources of funding. As of December 31, 2003, ALLETE's ratio of funded debt to total capital was .36 to 1.0, the interest coverage ratio was 5.83 to 1.00 and ALLETE was in compliance with these financial covenants.

ALLETE's lines of credit contain a cross-default provision, under which an event of default would arise if other ALLETE obligations in excess of $5.0 million were in default.

11 Long-Term Debt

Long-Term Debt

December 31	2003	2002
Millions		
First Mortgage Bonds		
6.68% Series Due 2007	$ 20.0	$ 20.0
7% Series Due 2007	60.0	60.0
7 1/2% Series Due 2007	35.0	35.0
7% Series Due 2008	50.0	50.0
6% Pollution Control Series E Due 2022	111.0	111.0
Floating Rate	–	250.0
6 1/4% Series	–	25.0
7 3/4% Series	–	50.0
Senior Notes		
7.70% Series A Due 2006	90.0	90.0
7.80% Due 2008	125.0	125.0
8.10% Series B Due 2010	35.0	35.0
Variable Notes		
Due 2006	45.0	–
Due 2020	28.4	–
Capital Lease Obligation Due 2013	34.5	–
Variable Demand Revenue Refunding Bonds Series 1997 A, B, C and D Due 2007 – 2020	39.0	39.0
Industrial Development Revenue Bonds, 6.50% Due 2025	35.1	35.1
Other Long-Term Debt, 2.0 – 8.8% Due 2004 – 2026	77.2	55.0
Total Long-Term Debt	785.2	980.1
Less Due Within One Year	(37.5)	(283.7)
Net Long-Term Debt	$747.7	$ 696.4

The aggregate amount of long-term debt maturing during 2004 is $37.5 million ($30.2 million in 2005; $137.1 million in 2006; $119.0 million in 2007; $182.3 million in 2008; and $279.1 million thereafter). Substantially all of our electric plant is subject to the lien of the mortgages securing various first mortgage bonds.

At December 31, 2003 we had long-term bank lines of credit aggregating $38.0 million ($39.7 million at December 31, 2002). Drawn portions on these lines of credit were $28.8 million in 2003 ($5.5 million in 2002).

In June 2003 ADESA restructured its financial arrangements with respect to four of its used vehicle auction facilities previously accounted for as operating leases. The transactions included the assumption of $28 million of long-term debt and the issuance of $45 million of long-term debt. The $28 million of assumed long-term debt matures April 1, 2020 and has a variable interest rate equal to the seven-day AA Financial Commercial Paper Rate plus approximately 1.2%, while the $45 million of long-term debt matures July 30, 2006 and has a variable interest rate of prime or LIBOR plus 1%.

In July 2003 ALLETE used internally generated funds to retire $25 million in principal amount of the Company's First Mortgage Bonds, Series 6 1/4% due July 1, 2003.

In July 2003 $250 million in principal amount of the Company's Floating Rate First Mortgage Bonds due October 20, 2003 were redeemed with proceeds from a $250 million credit agreement entered into in July 2003. (See Note 10.)

In November 2003 ALLETE redeemed $50 million in principal amount of the Company's First Mortgage Bonds, 7 3/4% Series due June 1, 2007. Internally generated funds and proceeds from the sale of Florida Water assets were used to repay the principal, premium and accrued interest, totaling approximately $52.1 million, to the bondholders.

In December 2003 ADESA recorded $34.5 million of long-term debt in connection with the capital lease obligation of one of its used vehicle auction facilities. The debt matures December 2013 and has a fixed rate of 5%.

In January 2004 we used internally generated funds to retire approximately $3.5 million in principal amount of Industrial Development Revenue Bonds Series 1994-A, due January 1, 2004.

ALLETE's long-term debt arrangements contain financial covenants. The most restrictive covenant requires ALLETE not to exceed a maximum ratio of funded debt to total capital of .65 to 1.0. Failure to meet this covenant could give rise to an event of default, if not corrected after notice from the trustee or security holder; in which event ALLETE may need to pursue alternative sources of funding. As of December 31, 2003 ALLETE's ratio of funded debt to total capital was .36 to 1.0 and ALLETE was in compliance with its financial covenants.

Some of ALLETE's long-term debt arrangements contain "cross-default" provisions that would result in an event of default if there is a failure under other financing arrangements to meet payment terms or to observe other covenants that would result in an acceleration of payments due.

The interest rate on the 7.80% Senior Note due 2008 will increase 0.50% to 1.00% in the event of a downgrade in ALLETE's senior unsecured long-term debt ratings below investment grade.

The 6.68% Series Due 2007 and the 7% Series Due 2007 cannot be redeemed prior to maturity. The 7 1/2% Series Due 2007 are redeemable after August 1, 2005 and the 7% Series Due 2008 are redeemable after March 1, 2006. The remaining debt may be redeemed in whole or in part at our option according to the terms of the obligations.

12 Mandatorily Redeemable Preferred Securities

In December 2003 ALLETE redeemed through ALLETE Capital I, a wholly owned statutory trust of ALLETE, all $75 million of its 8.05% QUIPS. The redemption price was $25 per QUIPS plus accumulated and unpaid distributions to the redemption date. The QUIPS were issued in March 1996 and represented preferred ownership interests in the assets of ALLETE Capital I. The sole asset of ALLETE Capital I was 8.05% Junior Subordinated Debentures, Series A, Due 2015 issued by ALLETE.

13 Common Stock and Earnings Per Share

Our Articles of Incorporation and mortgages contain provisions that, under certain circumstances, would restrict the payment of common stock dividends. As of December 31, 2003 no retained earnings were restricted as a result of these provisions.

Summary of Common Stock	Shares	Equity
Millions		
Balance at December 31, 2000	74.7	$576.9
2001 Public Offering	6.6	150.0
Employee Stock Purchase Plan	0.1	1.4
Invest Direct (a)	0.8	18.9
Other	1.7	23.1
Balance at December 31, 2001	83.9	770.3
2002 Employee Stock Purchase Plan	0.1	1.4
Invest Direct (a)	0.8	19.6
Other	0.8	23.6
Balance at December 31, 2002	85.6	814.9
2003 Employee Stock Purchase Plan	0.1	1.4
Invest Direct (a)	0.8	19.9
Other	0.8	23.0
Balance at December 31, 2003	87.3	$859.2

(a) Invest Direct is ALLETE's direct stock purchase and dividend reinvestment plan.

Common Stock Issuance. In May and June 2001 we sold 6.6 million shares of our common stock in a public offering at $23.68 per share. Total net proceeds of approximately $150 million were used to repay a portion of our short-term borrowings with the remainder invested in short-term instruments.

Shareholder Rights Plan. In 1996 we adopted a rights plan that provides for a dividend distribution of one preferred share purchase right (Right) to be attached to each share of common stock.

The Rights, which are currently not exercisable or transferable apart from our common stock, entitle the holder to purchase one two-hundredth of a share of ALLETE's Junior Serial Preferred Stock A, without par value, at an exercise price of $45. These Rights would become exercisable if a person or group acquires beneficial ownership of 15% or more of our common stock or announces a tender offer which would increase the person's or group's beneficial ownership interest to 15% or more of our common stock, subject to certain exceptions. If the 15% threshold is met, each Right entitles the holder (other than the acquiring person or group) to purchase common stock (or, in certain circumstances, cash, property or other securities of ours) having a market price equal to twice the exercise price of the Right. If we are acquired in a merger or business combination, or 50% or more of our assets or earning power are sold, each exercisable Right entitles the holder to purchase common stock of the acquiring or surviving company having a value equal to twice the exercise price of the Right. Certain stock acquisitions will also trigger a provision permitting the Board of Directors to exchange each Right for one share of our common stock.

The Rights which expire on July 23, 2006, are nonvoting and may be redeemed by us at a price of $0.005 per Right at any time they are not exercisable. One million shares of Junior Serial Preferred Stock A have been authorized and are reserved for issuance under the plan.

Earnings Per Share. The difference between basic and diluted earnings per share arises from outstanding stock options and performance share awards granted under our Executive and Director Long-Term Incentive Compensation Plans.

Reconciliation of Basic and Diluted Earnings Per Share	Basic EPS	Dilutive Securities	Diluted EPS
2003			
Income from Continuing Operations	$143.1	–	$143.1
Common Shares	82.8	0.5	83.3
Per Share from Continuing Operations	$1.72	–	$1.72
2002			
Income from Continuing Operations	$118.9	–	$118.9
Common Shares	81.1	0.6	81.7
Per Share from Continuing Operations	$1.47	–	$1.46
2001			
Income from Continuing Operations	$128.9	–	$128.9
Common Shares	75.8	0.7	76.5
Per Share from Continuing Operations	$1.70	–	$1.68

14 Jointly Owned Electric Facility

We own 80% of the 534-MW Boswell Energy Center Unit 4 (Boswell Unit 4). While we operate the plant, certain decisions about the operations of Boswell Unit 4 are subject to the oversight of a committee on which we and Wisconsin Public Power, Inc. (WPPI), the owner of the other 20% of Boswell Unit 4, have equal representation and voting rights. Each of us must provide our own financing and is obligated to pay our ownership share of operating costs. Our share of direct operating expenses of Boswell Unit 4 is included in operating expense on our consolidated statement of income. Our 80% share of the original cost included in electric plant at December 31, 2003 was $308 million ($310 million at December 31, 2002). The corresponding accumulated depreciation balance was $176 million at December 31, 2003 ($170 million at December 31, 2002).

15 Commitments, Guarantees and Contingencies

Square Butte Power Purchase Agreement. Minnesota Power has a power purchase agreement with Square Butte that extends through 2026 (Agreement). It provides a long-term supply of low-cost energy to customers in our electric service territory and enables Minnesota Power to meet power pool reserve requirements. Square Butte, a North Dakota cooperative corporation, owns a 455-MW coal-fired generating unit (Unit) near Center, North Dakota. The Unit is adjacent to a generating unit owned by Minnkota Power, a North Dakota cooperative corporation whose Class A members are also members of Square Butte. Minnkota Power serves as the operator of the Unit and also purchases power from Square Butte.

Minnesota Power is entitled to approximately 71% of the Unit's output under the Agreement. After 2005 and upon compliance with a two-year advance notice requirement, Minnkota Power has the option to reduce Minnesota Power's entitlement by 5% annually, to a minimum of 50%. In December 2003 we received notice from Minnkota Power that they will reduce our output entitlement, effective January 1, 2006, by 5% to approximately 66%.

Minnesota Power is obligated to pay its pro rata share of Square Butte's costs based on Minnesota Power's entitlement to Unit output. Minnesota Power's payment obligation is suspended if Square Butte fails to deliver any power, whether produced or purchased, for a period of one year. Square Butte's fixed costs consist primarily of debt service. At December 31, 2003 Square Butte had total debt outstanding of $284.2 million. Total annual debt service for Square Butte is expected to be $22.9 million in each of the years 2004 through 2008. Variable operating costs include the price of coal purchased from BNI Coal, our subsidiary, under a long-term contract.

Minnesota Power's cost of power purchased from Square Butte during 2003 was $52.3 million ($60.9 million in 2002 and $63.3 million in 2001). This reflects Minnesota Power's pro rata share of total Square Butte costs based on the 71% output entitlement in 2003, 2002 and 2001. Included in this amount was Minnesota Power's pro rata share of interest expense of $12.8 million in 2003 ($13.7 million in 2002; $14.2 million in 2001). Minnesota Power's payments to Square Butte are approved as purchased power expense for ratemaking purposes by both the MPUC and the FERC.

Leasing Agreements. In June 2003 ADESA restructured its financial arrangement with respect to its used vehicle auction facilities located in Tracy, California; Boston, Massachusetts; Charlotte, North Carolina; and Knoxville, Tennessee. These used vehicle auction facilities were previously accounted for as operating leases. The transactions included the assumption of $28 million of long-term debt, the issuance of $45 million of long-term debt and the recognition of $73 million of property, plant and equipment.

We lease other properties and equipment in addition to those listed above under operating lease agreements with terms expiring through 2032. The aggregate amount of minimum lease payments for all operating leases during 2004 is $14.8 million ($10.6 million in 2005; $8.2 million in 2006; $6.1 million in 2007; $5.7 million in 2008; and $59.0 million thereafter). Total rent expense was $27.4 million in 2003 ($26.7 million in 2002; $26.9 million in 2001).

Split Rock Energy. We provided up to $50.0 million of credit support, in the form of letters of credit and financial guarantees, to facilitate the power marketing activities of Split Rock Energy. Minimal credit support was outstanding at December 31, 2003 ($7.3 million at December 31, 2002). We withdrew from active participation in Split Rock Energy in February 2004.

Kendall County Power Purchase Agreement. We have 275 MW of nonregulated generation (non rate-base generation sold at market-based rates to the wholesale market) through an agreement with NRG Energy that extends through September 2017. Under the agreement we pay a fixed capacity charge for the right, but not the obligation, to capacity and energy from a 275 MW generating unit at NRG Energy's Kendall County facility near Chicago, Illinois. The annual fixed capacity charge is $21.8 million. We are also responsible for arranging the natural gas fuel supply. Our strategy is to enter into long-term contracts to sell a significant portion of the 275 MW from the Kendall County facility; the balance will be sold in the spot market through short-term agreements. We currently have 130 MW (100 MW in 2003) of long-term capacity sales contracts for the Kendall County generation, with 50 MW expiring in April 2012 and 80 MW in September 2017. Neither the Kendall County agreement nor the related sales contracts are derivatives under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." In total, the Kendall County facility operated at a loss in 2003 due to negative spark spreads (the differential between electric and natural gas prices) in the wholesale power market and our resulting inability to cover the fixed capacity charge on approximately 175 MW. We expect the facility to continue to generate losses until such time as spark spreads improve or we are able to enter into additional long-term capacity sales contracts.

Emerging Technology Investments. We have investments in emerging technologies through minority investments in venture capital funds and privately-held start-up companies. We have committed to make additional investments in certain emerging technology holdings. The total future commitment was $4.8 million at December 31, 2003 ($7.7 million at December 31, 2002) and is expected to be invested at various times through 2007.

Environmental Matters. Our businesses are subject to regulation by various U.S. and Canadian federal, state, provincial and local authorities concerning environmental matters. We do not currently anticipate that potential expenditures for environmental matters will be material; however, we are unable to predict the outcome of the issues discussed below.

SWL&P Manufactured Gas Plant. In May 2001 SWL&P received notice from the WDNR that the City of Superior had found soil contamination on property adjoining a former Manufactured Gas Plant (MGP) site owned and operated by SWL&P's predecessors from 1889 to 1904. The WDNR requested SWL&P to initiate an environmental investigation. The WDNR also issued SWL&P a Responsible Party letter in February 2002. The environmental investigation is underway. In February 2003 SWL&P submitted a Phase II environmental site investigation report to the WDNR. This report identified some MGP-like chemicals that were found in the soil. During March and April 2003 sediment samples were taken from nearby Superior Bay. The report on the results of this sampling is expected to be completed and sent to the WDNR during the first quarter of 2004. A work plan for additional investigation by SWL&P was filed on December 17, 2003 with the WDNR. This part of the investigation will determine any impact to soil or ground water between the former MGP site and the Superior Bay. Although it is not possible to quantify the potential clean-up cost until the investigation is completed and a work plan is developed, a $0.5 million liability was recorded as of December 31, 2003 to address the known areas of contamination. We have recorded a corresponding dollar amount as a regulatory asset to offset this liability. The PSCW has approved SWL&P's deferral of these MGP environmental investigation and potential clean-up costs for future recovery in rates, subject to regulatory prudency review.

Minnesota Power Coal-Fired Generating Facilities. During 2002 Minnesota Power received and responded to a third request from the EPA, under Section 114 of the federal Clean Air Act Amendments of 1990 (Clean Air Act), seeking additional information regarding capital expenditures at all of its coal-fired generating stations. This action is part of an industry-wide investigation assessing compliance with the New Source Review and the New Source Performance Standards (emissions standards that apply to new and changed units) of the Clean Air Act at electric generating stations. We have received no feedback from the EPA based on the information we submitted. There is, however, ongoing litigation involving the EPA and other electric utilities for alleged violations of these rules. It is expected that the outcome of some of the cases could provide the utility industry direction on this topic. We are unable to predict what actions, if any, may be required as a result of the EPA's request for information. As a result, we have not accrued any liability for this environmental matter.

Square Butte Generating Facility. In June 2002 Minnkota Power, the operator of Square Butte, received a Notice of Violation from the EPA regarding alleged New Source Review violations at the M.R. Young Station which includes the Square Butte generating unit. The EPA claims certain capital projects completed by Minnkota Power should have been reviewed pursuant to the New Source Review regulations potentially resulting in new air permit operating conditions. Minnkota Power has held several meetings with the EPA to discuss the alleged violations. Based on an EPA request, Minnkota Power performed a study related to the technological feasibility of installing various controls for the reduction of nitrogen oxides and sulfur dioxide emissions. Discussions with the EPA are ongoing and we are still unable to predict the outcome or cost impacts. If Square Butte is required to make significant capital expenditures to comply with EPA requirements, we expect such capital expenditures to be debt financed. Our future cost of purchased power would include our pro rata share of this additional debt service.

ADESA Impact Taunton Facility. In December 2003 the Massachusetts Department of Environmental Protection (MDEP) identified ADESA Impact as a potentially responsible party regarding contamination of several private drinking water wells in a residential development that abuts the Taunton, Massachusetts salvage vehicle auction facility. The wells had elevated levels of MTBE. MTBE is an oxygenating additive in gasoline to reduce harmful emissions. The EPA has identified MTBE as a possible carcinogen. ADESA Impact engaged GeoInsight, an environmental services firm, to conduct tests of its soil and groundwater at the salvage vehicle auction site.

GeoInsight prepared an immediate response action (IRA) plan, which is required by the MDEP, to determine the extent of the environmental impact and define activities to prevent further environmental contamination. The IRA plan, which was filed on January 24, 2004, describes the initial activities ADESA Impact performed, and proposes additional measures that it will use to further assess the existence of any imminent hazard to human health. In addition, as required by the MDEP, ADESA Impact is conducting an analysis to identify sensitive receptors that may have been affected, including area schools and municipal wells. GeoInsight does not believe that an imminent hazard condition exists at the Taunton site; however, the investigation and assessment of site conditions are ongoing.

In December 2003 GeoInsight collected soil samples, conducted groundwater tests and provided oversight for the installation of monitoring wells in various locations on and adjacent to the property adjoining the residential community. The results of the soil and water tests indicated levels of MTBE exceeding MDEP standards. In January 2004 we collected air samples from two residences that we identified as having elevated drinking water concentrations of MTBE. We have determined that inhalation of, or contact exposure to, this air poses minimal risk to human health. In response to our empirical findings, we have proposed to the MDEP that we install granular activated carbon filtration systems in the approximately 30 affected residences.

ADESA Impact is preparing an IRA status report that must be submitted to the MDEP by March 30, 2004, and will continue to prepare additional reports as necessary. As of December 31, 2003 ADESA Impact has accrued $0.7 million to cover the costs associated with ongoing testing, remediation and cleanup of the site.

ALLETE maintains pollution liability insurance coverage and has filed a claim with respect to this matter. We and our insurer are determining the availability of insurance coverage at this time.

Other. 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, compliance with regulations, rate base and cost of service issues, among other things. While the resolution of such matters could have a material effect on earnings and cash flows in the year of resolution, none of these matters are expected to change materially our present liquidity position, nor have a material adverse effect on our financial condition.

16 Income Tax Expense

Income Tax Expense

Year Ended December 31	2003	2002	2001
Millions			
Current Tax Expense			
Federal	$ 45.2	$36.4	$51.4
Foreign	14.0	12.6	7.6
State	10.1	7.1	7.7
	69.3	56.1	66.7
Deferred Tax Expense (Benefit)			
Federal	20.0	14.8	6.9
Foreign	–	0.1	0.2
State	3.1	0.7	(0.1)
	23.1	15.6	7.0
Change in Valuation Allowance	0.9	1.9	1.0
Deferred Tax Credits	(1.4)	(1.4)	(1.4)
Income Taxes on Continuing Operations	91.9	72.2	73.3
Income Taxes on Discontinued Operations	51.6	12.8	7.2
Total Income Tax Expense	$143.5	$85.0	$80.5

Reconciliation of Taxes from Federal Statutory Rate to Total Income Tax Expense

Year Ended December 31	2003	2002	2001
Millions			
Tax Computed at Federal Statutory Rate	$133.0	$77.8	$76.7
Increase (Decrease) in Tax			
State Income Taxes — Net of Federal Income Tax Benefit	17.3	9.8	8.6
Foreign Taxes	1.9	3.0	1.9
Other	(8.7)	(5.6)	(6.7)
Total Income Tax Expense	$143.5	$85.0	$80.5

Income Before Income Taxes

Year Ended December 31	2003	2002	2001
Millions			
United States	$341.9	$191.4	$197.3
Canadian	38.0	30.8	21.9
Total	$379.9	$222.2	$219.2

Deferred Tax Assets and Liabilities

December 31	2003	2002
Millions		
Deferred Tax Assets		
Employee Benefits and Compensation	$ 49.7	$ 43.4
Property Related	30.2	27.3
Investment Tax Credits	14.8	15.8
Allowance for Bad Debts	9.8	11.5
State NOL Carryover	8.7	8.6
Other	30.6	26.7
Gross Deferred Tax Assets	143.8	133.3
Deferred Tax Asset Valuation Allowance	(8.7)	(7.8)
Total Deferred Tax Assets	135.1	125.5
Deferred Tax Liabilities		
Property Related	229.6	215.7
Investment Tax Credits	21.0	22.4
Intangibles	19.7	13.4
Employee Benefits and Compensation	15.1	9.0
Other	10.4	4.8
Total Deferred Tax Liabilities	295.8	265.3
Accumulated Deferred Income Taxes	$160.7	$139.8

State net operating loss carryforwards of $8.7 million have an $8.2 million valuation allowance, as we believe more likely than not they will expire before they are utilized. These state net operating losses expire between 2004 and 2022.

Undistributed Earnings. Undistributed earnings of our foreign subsidiaries were approximately $24.5 million at December 31, 2003 ($28.8 million at December 31, 2002). Since this amount has been or will be reinvested in property, plant and working capital, we have not recorded the deferred taxes associated with the repatriation of these investments.

17 Other Comprehensive Income

Other Comprehensive Income

Year Ended December 31	Pre-Tax Amount	Tax Expense (Benefit)	Net-of-Tax Amount
Millions			
2003			
Unrealized Gain (Loss) on Securities			
Gain During the Year	$ 2.4	$ 1.0	$ 1.4
Add: Loss Included in Net Income	3.5	1.3	2.2
Net Unrealized Gain on Securities	5.9	2.3	3.6
Interest Rate Swap	0.2	–	0.2
Foreign Currency Translation Adjustments	39.2	–	39.2
Additional Pension Liability	(10.8)	(4.5)	(6.3)
Other Comprehensive Income	$ 34.5	$(2.2)	$36.7
2002			
Unrealized Gain (Loss) on Securities			
Loss During the Year	$(11.8)	$(4.3)	$(7.5)
Less: Gain Included in Net Income	1.0	0.4	0.6
Net Unrealized Loss on Securities	(12.8)	(4.7)	(8.1)
Interest Rate Swap	2.3	1.0	1.3
Foreign Currency Translation Adjustments	2.6	–	2.6
Additional Pension Liability	(6.0)	(2.5)	(3.5)
Other Comprehensive Loss	$(13.9)	$(6.2)	$(7.7)
2001			
Unrealized Gain (Loss) on Securities			
Gain During the Year	$ 3.6	$ 1.1	$ 2.5
Less: Gain Included in Net Income	–	–	–
Net Unrealized Gain on Securities	3.6	1.1	2.5
Interest Rate Swap	(2.5)	(1.0)	(1.5)
Foreign Currency Translation Adjustments	(11.3)	–	(11.3)
Other Comprehensive Loss	$(10.2)	$ 0.1	$(10.3)

Accumulated Other Comprehensive Income

December 31	2003	2002
Millions		
Unrealized Gain (Loss) on Securities	$ 0.8	$ (2.8)
Interest Rate Swap Loss	–	(0.2)
Foreign Currency Translation Gain (Loss)	23.5	(15.7)
Additional Pension Liability	(9.8)	(3.5)
	$14.5	$(22.2)

18 Pension and Other Postretirement Benefit Plans

We have noncontributory defined benefit pension plans covering eligible Corporate and Energy Services' employees. The plans provide defined benefits based on years of service and final average pay. We also have defined contribution pension plans covering substantially all employees, for which the annual aggregate cost was $9.1 million in 2003 ($9.7 million in 2002; $7.1 million in 2001).

We have postretirement health care and life insurance plans covering eligible Corporate and Energy Services' employees. The postretirement health plans are contributory with participant contributions adjusted annually. Postretirement health and life benefits are funded through a combination of Voluntary Employee Benefit Association trusts (VEBAs) established under section 501(c)(9) of the Internal Revenue Code and an irrevocable grantor trust. Contributions deductible for income tax purposes are made directly to the VEBAs; nondeductible contributions are made to the irrevocable grantor trust. Amounts are transferred from the irrevocable grantor trust to the VEBAs when they become deductible for income tax purposes.

We use a September 30 measurement date for the pension and postretirement health and life plans.

Pension Obligation and Funded Status

At September 30	2003	2002
Millions		
Change in Benefit Obligation		
Obligation, Beginning of Year	$297.9	$259.1
Service Cost	6.7	5.6
Interest Cost	19.5	19.5
Actuarial Loss	45.7	29.4
Benefits Paid	(16.4)	(15.7)
Obligation, End of Year	353.4	297.9
Change in Plan Assets		
Fair Value, Beginning of Year	265.7	281.9
Actual Return on Assets	33.5	(3.3)
Benefits Paid	(16.4)	(15.7)
Other	2.5	2.8
Fair Value, End of Year	285.3	265.7
Funded Status	(68.1)	(32.2)
Unrecognized Amounts		
Net Loss	82.3	43.3
Prior Service Cost	6.0	6.9
Transition Obligation	0.3	0.4
Net Asset Recognized	$ 20.5	$ 18.4
Amounts Recognized in Consolidated Balance Sheet Consist of:		
Prepaid Pension Cost	$ 31.9	$ 27.8
Accrued Benefit Liability	(31.2)	(18.8)
Intangible Asset	3.0	3.4
Accumulated Other Comprehensive Income	16.8	6.0
Net Asset Recognized	$ 20.5	$ 18.4

Components of Net Periodic Pension Expense (Income)

Year Ended December 31	2003	2002	2001
Millions			
Service Cost	$ 6.7	$ 5.6	$ 4.4
Interest Cost	19.5	19.5	18.3
Expected Return on Assets	(28.8)	(30.4)	(29.6)
Amortized Amounts			
Unrecognized Gain	–	(1.4)	(2.5)
Prior Service Cost	0.9	0.8	0.5
Transition Obligation	0.2	0.2	0.5
Net Pension Income	$ (1.5)	$ (5.7)	$ (8.4)

Information for Pension Plan with an Accumulated Benefit Obligation in Excess of Plan Assets

At September 30	2003	2002
Millions		
Projected Benefit Obligation	$137.8	$114.1
Accumulated Benefit Obligation	$118.1	$99.8
Fair Value of Plan Assets	$95.1	$88.6

Additional Pension Information

Year Ended December 31	2003	2002	2001
Millions			
Increase in Minimum Liability Included in Other Comprehensive Income	$10.8	$6.0	–

The accumulated benefit obligation for all defined benefit pension plans was $303.5 million and $259.3 million at September 30, 2003 and 2002, respectively.

Postretirement Health and Life Obligation and Funded Status

At September 30	2003	2002
Millions		
Change in Benefit Obligation		
Obligation, Beginning of Year	$ 99.5	$ 78.5
Service Cost	3.7	2.9
Interest Cost	6.6	5.9
Actuarial Loss	10.8	15.0
Participant Contributions	0.9	1.1
Benefits Paid	(4.3)	(3.9)
Obligation, End of Year	117.2	99.5
Change in Plan Assets		
Fair Value, Beginning of Year	39.5	38.7
Actual Return on Assets	6.6	(1.5)
Employer Contribution	8.2	5.1
Participant Contributions	0.9	1.1
Benefits Paid	(4.3)	(3.9)
Fair Value, End of Year	50.9	39.5
Funded Status	(66.3)	(60.0)
Unrecognized Amounts		
Net Loss	23.9	15.1
Transition Obligation	22.4	25.0
Accrued Cost	$(20.0)	$(19.9)

Under SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," only assets in the VEBAs are treated as plan assets in the table above for the purpose of determining funded status. In addition to the postretirement health and life assets reported above, we had $20.2 million in an irrevocable grantor trust at December 31, 2003 ($15.1 million at December 31, 2002). We consolidate the irrevocable grantor trust and it is included in Investments on our consolidated balance sheet.

Components of Net Periodic Postretirement Health and Life Expense

Year Ended December 31	2003	2002	2001
Millions			
Service Cost	$ 3.7	$ 2.9	$ 2.7
Interest Cost	6.6	5.9	5.3
Expected Return on Assets	(4.0)	(3.9)	(3.5)
Amortized Amounts			
Unrecognized Gain	0.1	(0.2)	(0.9)
Transition Obligation	2.4	2.4	2.4
Net Expense	$ 8.8	$ 7.1	$ 6.0

Weighted-Average Assumptions Used to Determine Benefit Obligations

At September 30	2003	2002
Discount Rate	6.0%	6.75%
Rate of Compensation Increase	3.5 - 4.5%	3.5 - 4.5%
Health Care Trend Rates:		
Trend Rate	10%	10%
Ultimate Trend Rate	5%	5%
Year Ultimate Trend Rate Effective	2008	2008

Weighted-Average Assumptions Used to Determine Net Periodic Benefit Costs

Year Ended December 31	2003	2002	2001
Discount Rate	6.75%	7.75%	8.00%
Expected Long-Term Return on Plan Assets:			
Pension	9.5%	10.0%	10.25%
Postretirement Health and Life	7.6 - 9.5%	8.0 - 10.0%	6.0 - 10.0%
Rate of Compensation Increase	3.5 - 4.5%	3.5 - 4.5%	3.5 - 4.5%

In establishing the expected long-term return on plan assets, we consider the diversification and allocation of plan assets, the actual long-term historical performance for the type of securities invested in, the actual long-term historical performance of plan assets and the impact of current economic conditions, if any, on long-term historical returns. The expected long-term return on plan assets used to determine 2004 pension expense is 9.0%.

Sensitivity of a One-Percentage-Point Change in Health Care Trend Rates

	One Percent Increase	One Percent Decrease
Millions		
Effect on Total of Postretirement Health and Life Service and Interest Cost	$1.9	$(1.4)
Effect on Postretirement Health and Life Obligation	$18.8	$(12.6)

Plan Asset Allocations

At September 30	2003	2002
Pension Plan Asset Categories:		
Equity Securities	61.6%	44.0%
Debt Securities	27.8	32.9
Real Estate	2.8	12.1
Venture Capital	5.6	9.0
Cash	2.2	2.0
	100.0%	100.0%
Postretirement Health and Life Asset Categories (includes VEBAs and irrevocable grantor trust):		
Equity Securities	62.2%	56.4%
Debt Securities	36.3	43.6
Cash	1.5	–
	100.0%	100.0%

Pension plan equity securities include ALLETE common stock in the amounts of $25.8 million (9.1% of total plan assets) and $20.3 million (7.7% of total plan assets) at September 30, 2003 and 2002, respectively.

To achieve strong returns within managed risk we diversify our asset portfolio to approximate the target allocations in the table below. Equity securities are diversified among domestic companies with large, mid and small market capitalizations, as well as investments in international companies. In addition, all debt securities must have a Standard & Poor's credit rating of A or higher.

Plan Asset Target Allocations

Pension Plan Asset Categories:	
Equity Securities	58%
Debt Securities	30
Real Estate	5
Venture Capital	6
Cash	1
	100%
Postretirement Health and Life Asset Categories (includes VEBAs and irrevocable grantor trust):	
Equity Securities	62%
Debt Securities	35
Cash	3
	100%

We expect to contribute approximately $8 million to our defined benefit pension plans and $7 million to our postretirement health and life plans in 2004.

19 Employee Stock and Incentive Plans

Employee Stock Ownership Plan. We sponsor a leveraged employee stock ownership plan (ESOP) within the Retirement Savings and Stock Ownership Plan that covers eligible Corporate and Energy Services' employees. In 1989 the ESOP used the proceeds from a $16.5 million third-party loan, guaranteed by us, to purchase 1.2 million shares of our common stock on the open market. The remaining principal balance on the loan was refinanced in 2002. The refinanced loan has a variable interest rate based on LIBOR and matures on December 31, 2004. In 1990 the ESOP issued a $75 million note (term not to exceed 25 years at 10.25%) to us as consideration for 5.6 million shares of our newly issued common stock. The Company makes annual contributions to the ESOP equal to the ESOP's debt service less available dividends received by the ESOP. The majority of dividends received by the ESOP are used to pay debt service, with the balance distributed to certain participants. The ESOP shares were initially pledged as collateral for its debt. As the debt is repaid, shares are released from collateral and allocated to participants, based on the proportion of debt service paid in the year. The third-party debt of the ESOP is recorded as long-term debt and the shares pledged as collateral are reported as unearned ESOP shares on our consolidated balance sheet. As shares are released from collateral, the Company reports compensation expense equal to the current market price of the shares, and the shares become outstanding for earnings-per-share computations. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings; available dividends on unallocated ESOP shares are recorded as a reduction of debt and accrued interest. ESOP compensation expense was $3.7 million in 2003 ($3.9 million in 2002; $2.6 million in 2001).

Year Ended December 31	2003	2002	2001
Millions			
ESOP Shares			
Allocated	3.6	3.8	3.9
Unreleased	3.4	3.7	4.0
Total	7.0	7.5	7.9
Fair Value of Unreleased Shares	$105.0	$84.0	$100.3

Stock Option and Award Plans. We have an Executive Long-Term Incentive Compensation Plan (Executive Plan) and a Director Long-Term Stock Incentive Plan (Director Plan). The Executive Plan allows for the grant of up to 9.7 million shares of our common stock to key employees. To date, these grants have taken the form of stock options, performance share awards and restricted stock awards. The Director Plan allows for the grant of up to 0.3 million shares of our common stock to nonemployee directors. Each nonemployee director receives an annual grant of 1,500 stock options and a biennial grant of performance shares equal to $10,000 in value of common stock at the date of grant. Stock options are exercisable at the market price of common shares on the date the options are granted, and vest in equal annual installments over two years with expiration ten years from the date of grant. Performance shares are earned over multi-year time periods and are contingent upon the attainment of certain performance goals of ALLETE. Restricted stock vests once certain periods of time have elapsed. At December 31, 2003, 3.8 million and 0.1 million shares were held in reserve for future issuance under the Executive Plan and Director Plan, respectively.

Stock Option Activity	Options	Average Exercise Price
Options in Millions		
2003		
Outstanding, Beginning of Year	2.3	$22.48
Granted	0.7	$20.59
Exercised	(0.6)	$20.44
Cancelled	(0.1)	$22.71
Outstanding, End of Year	2.3	$21.49
Exercisable, End of Year	1.4	$22.42
Fair Value of Options Granted During the Year	$2.72	
2002		
Outstanding, Beginning of Year	2.3	$20.18
Granted	0.8	$25.92
Exercised	(0.7)	$18.70
Cancelled	(0.1)	$23.77
Outstanding, End of Year	2.3	$22.48
Exercisable, End of Year	1.3	$20.23
Fair Value of Options Granted During the Year	$4.55	
2001		
Outstanding, Beginning of Year	2.4	$18.52
Granted	0.8	$23.63
Exercised	(0.8)	$18.39
Cancelled	(0.1)	$21.05
Outstanding, End of Year	2.3	$20.18
Exercisable, End of Year	1.2	$19.55
Fair Value of Options Granted During the Year	$3.89	

At December 31, 2003 options outstanding consisted of 0.2 million with an exercise price of $13.69 to $16.25, and 2.1 million with an exercise price of $20.51 to $25.68. The options with an exercise price of $13.69 to $16.25 have an average remaining contractual life of 5.4 years with 0.2 million exercisable on December 31, 2003 at an average price of $15.82. The options with an exercise price of $20.51 to $25.68 have an average remaining contractual life of 7.5 years with 1.2 million exercisable on December 31, 2003 at an average price of $23.53.

A total of 0.1 million performance share grants were awarded in February 2004 for performance periods ending in 2005 and 2006. The ultimate issuance is contingent upon the attainment of certain future performance goals of ALLETE during the performance periods. The grant date fair value of the performance share awards was $1.9 million.

A total of 0.3 million performance share grants were awarded in 2002 and 2003 for the performance period ended December 31, 2003. The grant date fair value of the share awards was $8.3 million. In early 2004, 50% of the shares will be issued with the balance to be issued in 2005.

In February 2004 we granted stock options to purchase approximately 0.1 million shares of common stock (exercise price of $32.55 per share).

Employee Stock Purchase Plan. We have an Employee Stock Purchase Plan that permits eligible employees to buy up to $23,750 per year of our common stock at 95% of the market price. At December 31, 2003, 1.3 million shares had been issued under the plan and 0.5 million shares were held in reserve for future issuance.

20 Quarterly Financial Data (Unaudited)

Information for any one quarterly period is not necessarily indicative of the results which may be expected for the year. Financial results for 2003 included a $71.6 million, or $0.86 per share, after-tax gain on the sale of substantially all our Water Services businesses ($0.2 million first quarter and second quarter; $3.0 million, or $0.04 per share, third quarter; $68.2 million, or $0.82 per share, fourth quarter). The gain was net of all selling, transaction and employee termination benefit expenses, as well as impairment losses on certain remaining assets. Financial results for the first quarter of 2002 included charges of $1.6 million, or $0.02 per share and the second quarter of 2002 included $2.3 million, or $0.03 per share, of charges related to exiting our vehicle transport business and retail store. Financial results for the fourth quarter of 2002 included a $5.5 million, or $0.07 per share, charge related to the indefinite delay of a generation project in Superior, Wisconsin.

Quarter Ended	Mar. 31	Jun. 30	Sept. 30	Dec. 31
Millions Except Earnings Per Share				
2003				
Operating Revenue	$422.9	$409.9	$397.1	$388.9
Operating Income from Continuing Operations	$62.4	$62.1	$65.3	$45.2
Net Income				
Continuing Operations	$38.0	$37.1	$39.4	$ 28.6
Discontinued Operations	6.3	7.3	8.2	71.5
	$44.3	$44.4	$47.6	$100.1
Earnings Available for Common Stock	$44.3	$44.4	$47.6	$100.1
Earnings Per Share of Common Stock				
Basic				
Continuing Operations	$0.46	$0.45	$0.47	$0.34
Discontinued Operations	0.08	0.09	0.10	0.86
	$0.54	$0.54	$0.57	$1.20
Diluted				
Continuing Operations	$0.46	$0.45	$0.47	$0.34
Discontinued Operations	0.08	0.08	0.10	0.86
	$0.54	$0.53	$0.57	$1.20
2002				
Operating Revenue	$367.2	$374.9	$387.9	$364.3
Operating Income from Continuing Operations	$54.7	$55.6	$60.5	$20.3
Net Income				
Continuing Operations	$33.2	$33.7	$38.3	$13.7
Discontinued Operations	2.0	5.1	6.8	4.4
	$35.2	$38.8	$45.1	$18.1
Earnings Available for Common Stock	$35.2	$38.8	$45.1	$18.1
Earnings Per Share of Common Stock				
Basic				
Continuing Operations	$0.42	$0.41	$0.47	$0.17
Discontinued Operations	0.02	0.07	0.08	0.05
	$0.44	$0.48	$0.55	$0.22
Diluted				
Continuing Operations	$0.42	$0.40	$0.47	$0.17
Discontinued Operations	0.02	0.07	0.08	0.05
	$0.44	$0.47	$0.55	$0.22

Report of Independent Auditors on Financial Statement Schedule

PRICEWATERHOUSECOOPERS

To the Board of Directors
of ALLETE, Inc.

Our audits of the consolidated financial statements referred to in our report dated February 9, 2004, except as to Note 3 which is as of March 8, 2004 appearing on page 60 of this Form 10-K of ALLETE, Inc. and its subsidiaries also included an audit of the Financial Statement Schedule listed in Item 15(a) of this Form 10-K. In our opinion, the Financial Statement Schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Minneapolis, Minnesota
February 9, 2004

Schedule II

ALLETE
Valuation and Qualifying Accounts and Reserves

For the Year Ended December 31		Balance at Beginning of Year	Additions: Charged to Income	Additions: Other Changes	Deductions from Reserves (a)	Balance at End of Period
Millions						
Reserve Deducted from Related Assets						
Reserve For Uncollectible Accounts						
2003	Trade Accounts Receivable	$ 8.8	$ 3.1	–	$ 3.5	$ 8.4
	Finance Receivables — Current	20.0	14.8	–	16.8	18.0
	Finance Receivables — Long-Term	1.7	–	–	0.5	1.2
2002	Trade Accounts Receivable	6.1	5.7	–	3.0	8.8
	Finance Receivables — Current	20.5	17.2	–	17.7	20.0
	Finance Receivables — Long-Term	2.7	0.4	–	1.4	1.7
2001	Trade Accounts Receivable	5.1	4.4	–	3.4	6.1
	Finance Receivables — Current	19.8	19.3	–	18.6	20.5
	Finance Receivables — Long-Term	2.6	0.2	–	0.1	2.7
Deferred Asset Valuation Allowance						
2003	Deferred Tax Assets	7.8	0.9	–	–	8.7
2002	Deferred Tax Assets	6.0	1.8	–	–	7.8
2001	Deferred Tax Assets	5.0	1.0	–	–	6.0

(a) Reserve for uncollectible accounts includes bad debts written off.

EXHIBIT INDEX

Exhibit Number	
2(b)	- Stock Purchase Agreement (without Exhibits and Schedules), dated November 20, 2003, by and between Philadelphia Suburban Corporation (now Aqua America, Inc.), as Purchaser, and ALLETE Water Services, Inc., as Shareholder.
10(o)3	- Amended Wholesale Power Coordination and Dispatch Operating Agreement, dated January 30, 2004, between Minnesota Power, Inc. (now ALLETE) and Split Rock Energy LLC.
10(p)	- Amended and Restated Withdrawal Agreement (without Exhibits and Schedules), dated January 30, 2004, by and between Great River Energy and Minnesota Power (now ALLETE). [Portions of this exhibit have been omitted pursuant to a request for confidential treatment and filed separately with the SEC.]
10(s)	- Third Amended and Restated Committed Facility Letter (without Exhibits), dated December 23, 2003, to ALLETE from LaSalle Bank National Association, as Agent.
+10(t)2	- November 2003 Amendment to the Minnesota Power (now ALLETE) Executive Annual Incentive Plan.
+10(u)	- ALLETE and Affiliated Companies Supplemental Executive Retirement Plan, as amended and restated, effective January 1, 2004.
+10(v)2	- Amendments through December 2003 to the Minnesota Power and Affiliated Companies Executive Investment Plan-I.
+10(w)2	- Amendments through December 2003 to the Minnesota Power and Affiliated Companies Executive Investment Plan-II.
+10(z)2	- Amendments through December 2003 to the Minnesota Power (now ALLETE) Director Stock Plan.
+10(aa)2	- October 2003 Amendment to the Minnesota Power (now ALLETE) Director Compensation Deferral Plan.
12	- Computation of Ratios of Earnings to Fixed Charges (Unaudited).
23(a)	- Consent of Independent Accountants.
23(b)	- Consent of General Counsel.
31(a)	- Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(b)	- Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	- Section 1350 Certification of Annual Report by the Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

STOCK PURCHASE AGREEMENT

By and Between

PHILADELPHIA SUBURBAN CORPORATION

(Purchaser)

And

ALLETE WATER SERVICES, INC.

(Shareholder)

DATE: NOVEMBER 20, 2003

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

STOCK PURCHASE AGREEMENT

THIS STOCK PURCHASE AGREEMENT (this "**Agreement**") is made and entered into as of the 20th day of November, 2003, by and between **Philadelphia Suburban Corporation**, a Pennsylvania corporation (the "**Purchaser**"), and **ALLETE Water Services, Inc.**, a Minnesota corporation (the "**Shareholder**").

RECITALS

A. The Shareholder is the sole owner of 6,000 issued and outstanding shares of capital stock (the "**Stock**") of Heater Utilities, Inc., a South Carolina corporation (the "**Company**").

B. The Company owns all of the issued and outstanding capital stock of its two subsidiary corporations: (i) Brookwood Water Corporation, a North Carolina corporation ("**Brookwood**"), and (ii) LaGrange Waterworks Corporation, a North Carolina corporation ("**LaGrange**") (individually, each of Brookwood and LaGrange may herein be referred to as a "**Subsidiary**," and collectively, may be referred to herein as the "**Subsidiaries**").

C. The Company owns and operates approximately 450 community water systems and 33 wastewater utility systems within the State of North Carolina, and also owns and operates 2 small community water systems located in Carroll County, Virginia.

D. Brookwood owns and operates approximately 10 community water systems in and about Fayetteville, North Carolina (in Cumberland and Hoke Counties) and LaGrange owns and operates 3 community water systems in and about Fayetteville, North Carolina (in Cumberland County). Neither of the Subsidiaries owns or operates any wastewater utility systems.

E. The Purchaser desires to purchase the Stock held by the Shareholder and the Shareholder desires to sell the Stock to the Purchaser on the terms and subject to the conditions set forth in this Agreement.

F. Upon consummation of the purchase and sale of the Stock pursuant to this Agreement, the Purchaser will own all of the issued and outstanding capital stock of the Company.

AGREEMENT

In consideration of the foregoing Recitals and the mutual promises contained in this Agreement, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Purchaser and the Shareholder agree as follows:

ARTICLE 1

DEFINITIONS

For purposes of this Agreement, the following terms have the meanings specified:

"*Acquisition Proposal*" means any proposal relating to the possible acquisition of the Company, Brookwood and/or LaGrange, whether by way of (i) merger, (ii) purchase of any capital stock of any of the foregoing, or (iii) purchase of all or substantially all of the assets of the foregoing.

"*Affiliate*" when used in reference to a specified Person, means any Person that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with the specified Person.

"*Agreement*" has the meaning set forth in the introductory paragraph of this Agreement.

"*ALLETE, Inc.*" means ALLETE, Inc., a Minnesota corporation, the ultimate corporate parent of the Shareholder, Company and its Subsidiaries.

"*ALLETE, Inc. Guarantee*" means that certain ALLETE, Inc. Guarantee executed and delivered on the date hereof by ALLETE, Inc., the form of which is set forth as **Exhibit B** to this Agreement, and which will become effective only upon the Closing of this Agreement and shall be applicable only to obligations of the Shareholder that arise after the Closing Date.

"*Ancillary Documents*" has the meaning set forth in Section 3.3 of this Agreement.

"*Applicable Laws*" means any and all laws (including Environmental Laws), ordinances, constitutions, regulations, statutes, treaties, rules, codes, licenses, certificates, franchises, permits, requirements and Injunctions adopted, enacted, implemented, promulgated, issued, entered or deemed applicable by or under the authority of any Governmental Body having jurisdiction over a specified Person or any of such Person's properties or assets.

"*Balance Sheets*" has the meaning set forth in Section 3.12 of this Agreement.

"*Balance Sheet Date*" has the meaning set forth in Section 3.12 of this Agreement.

"*Basket Amount*" has the meaning set forth in Section 9.1(a) of this Agreement.

"*Benefit Plan*" means any and all bonus, stock option, restricted stock, stock purchase, stock appreciation, phantom stock, profit participation, profit-sharing, deferred compensation, severance, retention, pension, retirement, disability insurance, medical insurance, dental insurance, health insurance, or life insurance, death benefit, incentive, welfare and/or other benefit, compensation and/or retirement plan, policy, arrangement and/or Contract maintained, sponsored or participated in by the Company or any Subsidiary.

"*Brookwood*" has the meaning set forth in the Recitals to this Agreement.

"*Business*" means the ownership and/or operation of community water and wastewater utility systems which serve primarily residential customers and, to a much lesser extent, serve a commercial customer base. With respect to the Company, the Business refers to community water utility systems and wastewater utility systems, and with respect to the Subsidiaries, the Business refers to community water utility systems.

"*Cary Property*" has the meaning set forth in Section 5.14(a) of this Agreement.

"*Closing*" has the meaning set forth in Section 2.4(a) of this Agreement.

"*Closing Date*" has the meaning set forth in Section 2.4(a) of this Agreement.

"*Code*" means the Internal Revenue Code of 1986, as amended, or rules and regulations issued by the IRS pursuant to the Internal Revenue Code or any successor law.

"*Company*" has the meaning set forth in the Recitals to this Agreement.

"*Company Plan*" has the meaning set forth in Section 11.8(b) of this Agreement.

"*Competing Business*" has the meaning set forth in Section 3.26 of this Agreement.

"*Confidential Information*" means any information or compilation of information not generally known to the public or the industry or which the Company or the Subsidiaries have not disclosed to third parties without a written obligation of confidentiality, which is proprietary to the Company or the Subsidiaries, relating to the Company's or the Subsidiaries' procedures, techniques, methods, concepts, ideas, affairs, products, processes and services, including, but not limited to, information relating to marketing, merchandising, selling, research, development, manufacturing, purchasing, accounting, engineering, financing, costs, customers, plans, pricing, billing, needs of customers and products and services used by customers, all lists of customers and their addresses, prospects, sales calls, products, services, prices and the like as well as any specifications, formulas, plans, drawings, accounts or sales records, sales brochures, code books, manuals, trade secrets, knowledge, know-how, pricing strategies, operating costs, sales margins, methods of operations, invoices or statements and the like.

"*Contract*" means any agreement, lease of personal or mixed property, license, contract, obligation, promise, commitment, arrangement, understanding or undertaking, instrument, document (whether written or oral and whether express or implied) of any type, nature or description that is legally binding but excluding leases of Leased Real Estate. As used herein, the word "Contract" shall be limited in scope if modified by an adjective specifying the type of contract to which this Agreement or a Section hereof refers.

"*Convertible Securities*" means any and all securities convertible or exchangeable for any shares of capital stock of the Company or either Subsidiary, including, without limitation, common stock.

"*DOJ*" means the United States Department of Justice.

"*Debt Instruments*" has the meaning set forth in Section 3.29 of this Agreement.

"*Debt Securities*" means any and all indebtedness issued by or on behalf of the Company or either Subsidiary which constitutes a security under the Securities Act of 1933, as amended (the "**Securities Act**").

"*Developer Contracts*" has the meaning set forth in Section 3.16 of this Agreement.

"*Director Indemnified Party*" or "*Director Indemnified Parties*" has the meaning set forth in Section 11.9(a) of this Agreement.

"*Disclose*" means to reveal, deliver, divulge, disclose, publish, copy, communicate, show or otherwise make known or available to any other Person, or in any way to copy, any of the Confidential Information of the Company and/or its Subsidiaries.

"*Employees*" has the meaning set forth in Section 3.20(a) of this Agreement.

"*Encumbrance*" means and includes:

(i) with respect to any personal property, any intangible property or any property other than real property, any security or other property interest or right, claim, lien, pledge, option, charge, security interest, contingent or conditional sale, or other title claim or retention agreement or lease or use agreement in the nature thereof whether voluntarily incurred or arising by operation of law, and including any agreement to grant or submit to any of the foregoing in the future; and

(ii) with respect to any real property (whether and including Owned Real Estate or Leased Real Estate), any mortgage, lien, easement, interest, right-of-way, condemnation or eminent domain proceeding, encroachment, any building, use or other form of restriction, encumbrance or other claim (including adverse or prescriptive) or right of third parties (including Governmental Bodies), any lease or sublease, boundary dispute, and agreements with respect to any real property including: purchase, sale, right of first refusal, option, construction, building or property service, maintenance, property management, conditional or contingent sale, use or occupancy, franchise or concession, whether voluntarily incurred or arising by operation of law, and including any agreement to grant or submit to any of the foregoing in the future.

"*Environmental Assessment*" has the meaning set forth in Section 5.23 of this Agreement.

"*Environmental Assessment Firm*" has the meaning set forth in Section 5.23 of this Agreement.

"*Environmental Laws*" means any and all Applicable Laws (i) regulating the use, treatment, generation, transportation, storage, control, management, recycling or disposal of any Hazardous Material, including, but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act (42 U.S.C. § 9601 et seq.), the Resource Conservation and Recovery Act (42 U.S.C. § 6901 et seq.), the Hazardous Materials Transportation Act (49 U.S.C. § 1801 et seq.), the Federal Water Pollution Control Act (33 U.S.C. § 1251 et seq.), the Clean Water Act (33 U.S.C. § 1251 et seq.), the Clean Air Act (42 U.S.C. § 7401 et seq.), the Toxic Substances Control Act (15 U.S.C. § 2601 et seq.), and/or (ii) relating to the protection, preservation or conservation of the environment, all as existing, defined or interpreted as of the date hereof.

"*ERISA*" means the Employee Retirement Income Security Act of 1974, as amended.

"*ERISA Affiliate*" has the meaning set forth in Section 3.10(b) of this Agreement.

"*Existing Policy*" has the meaning set forth in Section 5.14(a) of this Agreement.

"*Final Order*" has the meaning set forth in Section 6.2 of this Agreement.

"*FTC*" means the United States Federal Trade Commission.

"*GAAP*" means generally accepted accounting principles in the United States.

"*Governmental Body*" means any:

(i) nation, state, county, city, town, village, district or other jurisdiction of any nature;

(ii) federal, state, local, municipal, foreign or other government;

(iii) governmental or quasi-governmental authority of any nature (including any governmental agency, branch, board, commission, department, instrumentality, office or other entity, and any court or other tribunal);

(iv) multinational organization or body; and/or

(v) body exercising, or entitled or purporting to exercise, any administrative, executive, judicial, legislative, police, regulatory or taxing authority or power of any nature.

"*HSR*" means the Hart Scott Rodino Antitrust Improvements Act of 1976, as amended.

"*Hazardous Materials*" means any and all (i) dangerous, toxic or hazardous pollutants, contaminants, chemicals, wastes, materials or substances listed or identified in, or directly or indirectly regulated by, any Environmental Law, and (ii) any of the following, whether or not included in the foregoing: polychlorinated biphenyls, asbestos in any form or condition, urea-formaldehyde, petroleum (including crude oil or any fraction thereof), natural gas, natural gas liquids, liquefied natural gas, synthetic gas usable for fuel or mixtures thereof, nuclear fuels or materials, chemical wastes, radioactive materials, explosives and known possible carcinogens.

"*IRS*" means the United States Internal Revenue Service.

"*Inactive Employees*" has the meaning set forth in Section 3.20(a) of this Agreement.

"*Indemnified Party*" has the meaning set forth in Section 9.3 of this Agreement.

"*Indemnifying Party*" has the meaning set forth in Section 9.3 of this Agreement.

"*Injunction*" means any and all writs, rulings, awards, directives, injunctions (whether temporary, preliminary or permanent), judgments, decrees or orders (whether executive, judicial or otherwise) adopted, enacted, implemented, promulgated, issued, entered or deemed applicable by or under the authority of any Governmental Body.

"*Intellectual Property*" means any and all (i) inventions (whether patentable or unpatentable and whether or not reduced to practice), all improvements thereto, and all patents, patent applications and patent disclosures, together with all reissuances, continuations, continuations in part, revisions, extensions and reexaminations thereof; (ii) trademarks, service marks, trade dress, logos, trade names, assumed names and corporate names, together with all translations, adaptations, derivations and combinations thereof and including all goodwill associated therewith, and all applications, registrations and renewals in connection therewith; (iii) copyrightable works, all copyrights and all applications, registrations and renewals in connection therewith; (iv) mask works and all applications, registrations and renewals in connection therewith; (v) trade secrets and confidential business information (including ideas, research and development, know-how, technology, formulas, compositions, manufacturing and production processes and techniques, technical data, designs, drawings, specifications, customer and supplier lists, pricing and cost information and business and marketing plans and proposals); (vi) computer software (including data and related software program documentation in computer-readable and hard-copy forms); (vii) other intellectual property and proprietary rights of any kind, nature or description, including web sites, web site domain names and other e-commerce assets and resources of any kind or nature; and (viii) copies of tangible embodiments thereof (in whatever form or medium).

"*Knowledge*" means, with respect to an individual who is a natural being, an individual's actual knowledge (following due inquiry and investigation) of a fact or other matter. With respect to an entity that is a party to this Agreement, "Knowledge" shall be solely attributed to the Knowledge of an officer, director, or the Senior Management Employees of the Purchaser, the Shareholder, the Company or the Subsidiaries, respectively, and as applicable to the context used in this Agreement. As used herein, the Knowledge of the Subsidiaries shall be attributed to the Company for purposes of this Agreement and, as a consequence, the "Knowledge of the Company" shall be deemed to include the Knowledge of the Subsidiaries.

"*LaGrange*" has the meaning set forth in the Recitals to this Agreement.

"*Leased Real Estate*" has the meaning set forth in Section 3.17 of this Agreement.

"*Leases*" has the meaning set forth in Section 3.17(a) of this Agreement.

"*Liability*" or "*Liabilities*" means any and all debts, liabilities and/or obligations of any type, nature or description (whether known or unknown, asserted or unasserted, secured or unsecured, absolute or contingent, accrued or unaccrued, liquidated or unliquidated and whether due or to become due).

"*Loss*" or "*Losses*" has the meaning set forth in Section 9.1 of this Agreement.

"*Material Adverse Effect*" or "*Material Adverse Change*" means, in connection with the Company and the Subsidiaries (evaluated on the basis of the three (3) companies taken as a whole and not on an individual company-by-company basis) with due consideration to the size and complexity of the Business and transactions contemplated by this Agreement, any event, change or effect that is materially adverse, individually or in the aggregate, to the condition (financial or otherwise), properties, assets, Liabilities, revenues, income, business, operations,

results of operations of such Persons, taken as a whole; provided, however, that in no event shall any of the following constitute a material adverse change, or be deemed to have a material adverse effect, in the business, operations, assets, results of operations or condition of the Company and the Subsidiaries: (i) any change or effect resulting from conditions affecting the industry in which the Company and the Subsidiaries operate or from changes in general business or economic conditions, (ii) any change or effect resulting from the announcement or pendency of any of the transactions contemplated by this Agreement, (iii) any change or effect resulting from compliance by the Company and/or the Subsidiaries with the terms of, or the taking of any action contemplated or permitted by, this Agreement and any Ancillary Document, or (iv) any change or effect resulting from any change in Applicable Law. In furtherance of the foregoing, and notwithstanding anything to the contrary set forth in this Agreement, any Material Adverse Effect or any Material Adverse Change with respect to the Company and/or either of the Subsidiaries shall be evaluated on the basis of the Company and the Subsidiaries taken as a whole (in the aggregate) and not on an individual company-by-company basis.

"*NCDEH*" means the Division of Environmental Health of the Department of Environment and Natural Resources, a regulatory agency of the state of North Carolina which, among other things, regulates the issuance of water system permits and compliance with federal and state Applicable Laws.

"*NCDWQ*" means the Division of Water Quality of the Department of Environment and Natural Resources, a regulatory agency of the state of North Carolina which, among other things, regulates the issuance of wastewater permits and compliance with federal and state Applicable Laws.

"*NCUC*" means the North Carolina Utilities Commission, a regulatory agency of the state of North Carolina which, among other things, regulates rates, service and PCN Certificates of entities that own and/or operate water systems and wastewater utility systems.

"*Operating Contracts*" has the meaning set forth in Section 3.16 of this Agreement.

"*Ordinary Course of Business*" means an action taken by a Person only if:

(i) such action is consistent with the past practices of such Person and is taken in the ordinary course of the normal day-to-day operations of such Person; and

(ii) such action is not required to be authorized by the board of directors of such Person (or by any Person or group of Persons constituting a governing body of a Person exercising similar authority).

"*Overlap Period*" has the meaning set forth in Section 10.2 of this Agreement.

"*Owned Real Estate*" has the meaning set forth in Section 3.17 hereof.

"*PBGC*" means the Pension Benefit Guaranty Corporation.

"*PCBs*" has the meaning set forth in Section 3.28 of this Agreement.

"*PCN Certificates*" means the certificates of public convenience and necessity that are issued and regulated by the NCUC.

"*Permits*" means all right, title and interest in and to any permits, licenses, filings, authorizations, approvals, or other indicia of authority (and any pending applications for approval or renewal of a Permit), to own, construct, operate, sell, inventory, disburse or maintain any asset or conduct any business as issued by any Governmental Body.

"*Permitted Encumbrances*" has the meaning set forth in Section 3.17(c) of this Agreement.

"*Permitted Exceptions*" has the meaning set forth in Section 5.14(b) of this Agreement.

"*Person*" means any individual, corporation (including any non-profit corporation), general, limited or limited liability partnership, limited liability company, joint venture, estate, trust, association, organization, or other entity or Governmental Body.

"*Pre-Closing Period*" has the meaning set forth in Section 3.9(b) of this Agreement.

"*Proceeding*" means any suit, litigation, arbitration, hearing, audit, investigation, order, or other action (whether civil, criminal, administrative or investigative) noticed, commenced, brought, conducted, or heard by or before, or otherwise involving, any Governmental Body or arbitrator.

"*Purchase Price*" has the meaning set forth in Section 2.2 of this Agreement.

"*Purchaser*" has the meaning set forth in the introductory paragraph of this Agreement.

"*Purchaser Plan*" has the meaning set forth in Section 11.8(b) of this Agreement.

"*Real Estate*" has the meaning set forth in Section 3.17 of this Agreement.

"*Related Person*" or "*Related Persons*" means, with respect to a particular individual,

(i) each other member of such individual's Family (as hereafter defined); and

(ii) any Affiliate of one or more members of such individual's Family.

With respect to a specified Person other than an individual:

(i) any Affiliate of such specified Person; and

(ii) each Person that serves as a director, governor, officer, manager, general partner, executor or trustee of such specified Person (or in a similar capacity).

For purposes of this definition, the "*family*" of an individual includes (i) such individual, (ii) the individual's spouse, (iii) any lineal ancestor or lineal descendant of the individual, or (iv) a trust for the benefit of any of the foregoing.

"*Required Consent*" has the meaning set forth in Section 3.17(k) of this Agreement.

"*Retention and Severance Agreements*" has the meaning set forth in Section 3.37 of this Agreement.

"*Retention Payment*" has the meaning set forth in Section 3.37 of this Agreement.

"*Rights*" means any and all outstanding subscriptions, warrants, options, or other arrangements or commitments obligating or which may obligate (with or without notice or passage of time or both) the Company or either Subsidiary to issue or dispose of any of their respective (as opposed to third party) securities including, without limitation, Convertible Securities and Debt Securities.

"*Schedules*" has the meaning set forth in the introductory paragraph to Article 3 of this Agreement.

"*Securities Act*" has the meaning set forth in the definition of "Debt Securities" in Article 1 of this Agreement.

"*Senior Management Employee(s)*" means the chief executive officer, president, any vice president, the chief financial officer, treasurer or secretary of a party to this Agreement. With respect to the Company and the Subsidiaries, the Senior Management Employees shall mean and be limited solely to William E. Grantmyre, Jerry H. Tweed, Freda H. Hilburn, Kristin O. Brandenburg, Richard J. Durham, Kenneth Strickland, Ruel C. Shaw, Jill Strickler, Donald Sutter and Gary Moseley.

"*Severance Payment*" has the meaning set forth in Section 11.8(f) of this Agreement.

"*Shareholder*" has the meaning set forth in the introductory paragraph of this Agreement.

"*Shareholder Guarantee*" has the meaning set forth in Section 5.22(b) of this Agreement.

"*Shareholder's Representative*" has the meaning set forth in Section 10.2 of this Agreement.

"*Stock*" has the meaning set forth in the Recitals to this Agreement.

"*Subsidiary*" or "*Subsidiaries*" has the meaning set forth in the Recitals to this Agreement.

"*Supplement*" has the meaning set forth in Section 13.21 of this Agreement.

"*Tax*" or "*Taxes*" means any and all net income, gross income, gross revenue, gross receipts, net receipts, ad valorem, franchise, profits, transfer, sales, use, social security, employment, unemployment, disability, license, withholding, payroll, privilege, excise, value-added, severance, stamp, occupation, property, customs, duties, real estate and/or other taxes, assessments, levies, fees or charges of any kind whatsoever imposed by any Governmental Body, together with any interest or penalty relating thereto.

"*Tax Matter*" has the meaning set forth in Section 10.2 of this Agreement.

"*Tax Return*" or "*Tax Returns*" means any return, declaration, report, claim for refund or information return or statement relating to Taxes, including, without limitation, any schedule or attachment thereto, any amendment thereof, and any estimated report or statement.

"*Third Party Plans*" has the meaning set forth in Section 11.8(d) of this Agreement.

"*Threatened*" means a claim, Proceeding, dispute, action, or other matter for which any demand or statement has been made, orally or in writing, or any oral or written notice has been given, that would lead a reasonably prudent Person to conclude that such a claim, Proceeding, dispute, action, or other matter may, with reasonable certainty, be asserted, commenced, taken or otherwise pursued in the future; provided, however, that the foregoing shall not include customer billing or service disputes in the Ordinary Course of Business.

"*Title Documents*" has the meaning set forth in Section 5.14(a) of this Agreement.

"*Title Policy*" has the meaning set forth in Section 5.14(c) of this Agreement.

"*Transactional Expenses*" has the meaning set forth in Section 13.10 of this Agreement.

"*Use*" means to appropriate any of the Confidential Information of the Company and/or its Subsidiaries for the benefit of oneself or any other Person other than the Company.

"*VDH*" means the Office of Water Programs of the Virginia Department of Health, a regulatory agency of the Commonwealth of Virginia which, among other things, regulates the issuance of water system permits and compliance with federal and state Applicable Laws.

"*WARN Acts*" has the meaning set forth in Section 3.10(k) of this Agreement.

ARTICLE 2

PURCHASE OF STOCK; PURCHASE PRICE

2.1 Purchase and Sale of Stock. In reliance upon the representations, warranties and covenants contained in this Agreement as of the date hereof and on the Closing Date, the Purchaser agrees to purchase the Stock from the Shareholder, and the Shareholder agrees to sell, transfer, convey, assign and deliver the Stock to the Purchaser on the terms and conditions set forth in this Agreement. Such sale, transfer, conveyance, assignment and delivery of the Stock shall convey good and marketable title to the Stock, free and clear of any and all Rights and Encumbrances, and at such time the Stock will be fully paid and non-assessable. At the Closing the Shareholder will deliver to the Purchaser certificate(s) evidencing the Stock duly endorsed in blank or with stock powers duly executed by the Shareholder.

2.2 Purchase Price. The purchase price to be paid to the Shareholder by the Purchaser for the Stock (the "**Purchase Price**") shall be Forty-Eight Million Dollars ($48,000,000).

2.3 Payment of Purchase Price on the Closing Date. The Purchase Price shall be paid on the Closing Date by wire transfer of immediately available funds to an account (or accounts) designated by the Shareholder at least two (2) business days prior to the Closing.

2.4 Closing and Closing Deliveries.

(a) Closing and Closing Date. Subject to the satisfaction or waiver of the conditions precedent contained in Articles 6, 7 and 8 hereof, the closing of the transactions contemplated by this Agreement (the "**Closing**") shall be held at a mutually agreed time, but in no event no more than ten (10) business days after (i) all consents and approvals (including the Final Order(s) described and defined in Section 6.2 of this Agreement) required to consummate the transactions contemplated hereby have been received from any Governmental Body, including the FTC, DOJ, the NCUC and the VDH, and (ii) all other conditions to the Closing have been duly satisfied or waived in writing, at the offices of Briggs and Morgan, Professional Association, 2400 IDS Center, Minneapolis, Minnesota, 55402. The Closing shall be effective as of 11:59 P.M. on the date of Closing and such date is referred to in this Agreement as the "**Closing Date**."

(b) Closing Deliveries by the Shareholder. At the Closing, the Shareholder shall execute, where necessary or appropriate, and deliver to the Purchaser each and all of the following:

(i) A certificate in the form of **Exhibit A** hereto signed by a duly authorized officer of the Shareholder, and dated as of the Closing Date, to the effect that the representations and warranties made by the Shareholder in this Agreement (as modified by the Schedules and any Supplement(s)) and in any document, instrument and/or agreement to be executed and delivered by the Shareholder pursuant to this Agreement are true and correct in all material respects at and as of the Closing and the Shareholder has performed and complied with all of its covenants, agreements and obligations under this Agreement which are to be performed and complied with by the Shareholder on or prior to the Closing Date;

(ii) The certificates evidencing the Stock duly endorsed by the Shareholder in blank or accompanied by stock powers duly executed by the Shareholder;

(iii) A copy certified by the Secretary of the Shareholder of the duly adopted resolutions of the Board of Directors of the Shareholder approving this Agreement, including the Ancillary Documents, authorizing the execution and delivery of this Agreement and the Ancillary Documents, and the consummation of the transactions contemplated hereby and thereby;

(iv) The corporate minute books, the corporate seals, and stock books for the Company and the Subsidiaries;

(v) A satisfaction of debt in a form satisfactory to the Purchaser executed by the Shareholder with respect to the payment of intercompany

liabilities and obligations between the Shareholder and its Affiliates (other than the Company and the Subsidiaries) and the Company and the Subsidiaries;

(vi) Delivery of any and all documents relating to Permits;

(vii) A duly executed written opinion letter by counsel for the Shareholder, dated as of the Closing Date, addressed to the Purchaser, as contemplated by Section 7.4 of this Agreement;

(viii) Duly executed resignations of (A) the officers of the Company and the Subsidiaries who are also officers of the Shareholder, and (B) the directors of the Company and the Subsidiaries, effective as of the Closing Date;

(ix) Certificates of good standing for the Shareholder, the Company and each of the Subsidiaries dated within five (5) days of the Closing Date issued by the Secretary of State of their respective states of incorporation;

(x) The non-foreign person affidavit required by Section 1445 of the Code;

(xi) The termination documents for the guarantees described in Section 5.22;

(xii) Evidence reasonably satisfactory to the Purchaser that the Company and the Subsidiaries have arranged for the payment of the Retention Payments concurrently upon the Closing; and

(xiii) Such other documents and items as are reasonably necessary or appropriate to effect the consummation of the transactions contemplated hereby or which may be customary under local law.

(c) Closing Deliveries by the Purchaser. At the Closing, the Purchaser shall execute, where necessary or appropriate, and deliver to the Shareholder each and all of the following:

(i) Payment of the Purchase Price in the manner set forth in Section 2.3 of this Agreement;

(ii) A certificate in the form of **Exhibit C** hereto signed by a duly authorized officer of the Purchaser, and dated as of the Closing Date, to the effect that the representations and warranties made by the Purchaser in this Agreement (as modified by the Schedules and any Supplement(s)) and in any document, instrument and/or agreement to be executed and delivered by the Purchaser pursuant to this Agreement are true and correct in all material respects at and as of the Closing and the Purchaser has performed and complied with all of its covenants, agreements and obligations under this Agreement which are to be performed and complied with by the Purchaser on or prior to the Closing Date;

(iii) A copy certified by the Secretary of the Purchaser of the duly adopted resolutions of the Board of Directors of the Purchaser approving this Agreement, including the Ancillary Documents, and authorizing the execution and delivery of this Agreement, including the Ancillary Documents, and the consummation of the transactions contemplated hereby and thereby;

(iv) A duly executed written opinion letter by counsel for the Purchaser, dated as of the Closing Date, addressed to the Shareholder, as contemplated by Section 8.3 of this Agreement;

(v) Evidence reasonably satisfactory to the Shareholder that the performance and other bonds required by Section 5.25 have been secured in accordance with the provisions of such section;

(vi) A certificate of good standing of the Purchaser dated within five (5) days of the Closing Date issued by the Secretary of State of the Purchaser's state of incorporation; and

(vii) Such other documents and items as are reasonably necessary or appropriate to effect the consummation of the transactions contemplated hereby or which may be customary under local law.

ARTICLE 3

REPRESENTATIONS AND WARRANTIES OF THE SHAREHOLDER

As an inducement for the Purchaser to enter into this Agreement and to consummate the transactions contemplated hereby, the Shareholder represents and warrants to the Purchaser that each and all of the following representations and warranties (as modified by the Schedules to this Agreement (the "**Schedules**") and any Supplement delivered by the Shareholder pursuant to Section 13.21 of this Agreement) are true and correct as of the date of this Agreement and will be true and correct as of the Closing Date. The Schedules shall be arranged in paragraphs corresponding to the sections and subsections contained in this Article 3.

3.1 Organization.

(a) The Shareholder. The Shareholder is a Minnesota corporation and is duly organized, validly existing and in good standing under the laws of Minnesota. The Shareholder has all requisite power and authority to own, operate and lease its properties and assets (including the Stock) and to conduct its business as it is now being conducted.

(b) The Company and the Subsidiaries. The Company and the Subsidiaries each (i) are a corporation duly organized, validly existing and in good standing under the laws of their respective states of incorporation, (ii) have all requisite power and authority, corporate and otherwise, to own, operate and lease its properties and assets and to conduct the Business as it is now being conducted by each entity. The Business is the only business conducted by the Company and the Subsidiaries. As set forth in **Schedule 3.1(b)**, each of the Company and the Subsidiaries is duly qualified to transact

business as a foreign corporation and is in good standing under the laws of every state or jurisdiction in which the nature of their activities or of their properties (owned, leased or operated) makes such qualification necessary and in which the failure to be so qualified could not reasonably be expected to have a Material Adverse Effect.

3.2 Capitalization. The authorized capital stock of the Company consists solely of 6,000 shares of common voting stock, One Dollar ($1.00) par value, of which 6,000 shares are issued and outstanding on the date hereof, and are owned beneficially and of record by the Shareholder, free and clear of all liens and Encumbrances. The Company is the sole legal, beneficial and equitable shareholder of all of the equity interests in and with respect to the Subsidiaries. None of the Stock has been issued in violation of the rights of any Person. Except as set forth in **Schedule 3.2** hereto, as of the date hereof, (i) there are no Convertible Securities or Debt Securities outstanding, (ii) there are no Rights outstanding, and (iii) there are no shareholder agreements or other agreements, understandings or commitments relating to the rights of the Shareholder to vote or dispose of the Stock.

3.3 Due Authorization. The execution, delivery and performance of this Agreement, including the documents, instruments and agreements to be executed and delivered by the Shareholder pursuant to this Agreement (the "**Ancillary Documents**"), and the consummation of the transactions contemplated hereby and thereby have been duly and validly authorized by all necessary corporate action on the part of the Shareholder. This Agreement and the Ancillary Documents have been, or will be on or before the Closing Date, duly and validly authorized, executed and delivered by the Shareholder, and the obligations of the Shareholder hereunder and thereunder are or will be, upon such execution and delivery, valid, legally binding and enforceable against the Shareholder in accordance with their respective terms.

3.4 No Breach. The Shareholder has full power and authority, corporate and otherwise, to sell, assign, transfer, convey and deliver the Stock to the Purchaser and to otherwise perform its obligations under this Agreement and the Ancillary Documents. The execution and delivery of this Agreement and the Ancillary Documents to be executed and delivered by the Shareholder pursuant to this Agreement, and the consummation of the transactions contemplated hereby and thereby will not: (i) violate any provision of the Articles of Incorporation or Bylaws of the Shareholder, (ii) except as set forth in **Schedule 3.4**, or as contemplated by clause (iii) immediately following, violate any Applicable Laws or Injunction applicable to the Shareholder, the Company or the Subsidiaries, (iii) other than the filings required by HSR, the NCUC, and the VDH, and except as provided in **Schedule 3.4** hereto, require any filing with, Permits from, authorization, consent or approval of, or the giving of any notice to, any Person, (iv) except as provided in **Schedule 3.4** hereto, result in a violation or breach of, or constitute (with or without due notice or lapse of time or both) a default (or give another party any rights of termination, cancellation or acceleration) under any of the terms, conditions or provisions of any note, bond, mortgage, indenture, license, franchise, Permit (including, but not limited to, any Permits, approvals or authorizations of any Governmental Body), lease or other Contract to which the Company and/or the Shareholder is a party, or by which they or any of their properties or assets may be bound, or (v) result in the creation or imposition of any Encumbrance on any of the properties or assets of the Company or the Subsidiaries, such that in the case of any violation or the absence of Permit, consent or approval

described in clauses (ii), (iii) and (iv) above, the occurrence or omission of which would not be reasonably likely to have a Material Adverse Effect.

3.5 Clear Title. Except as otherwise set forth in **Schedule 3.5** or the leased property disclosed in **Schedule 3.16** hereto, on the Closing Date, (i) the Company and each of the Subsidiaries will hold good title to their respective personal property, and (ii) such personal property is and shall be free and clear of any and all Encumbrances of any kind, nature and description whatsoever, except for Encumbrances which are disclosed, reflected or reserved for or against in the Balance Sheets.

3.6 Condition of Assets. Except as set forth in **Schedule 3.6** hereto, all of the properties and assets of the Company and the Subsidiaries (i) have been maintained in accordance with industry standards in all material respects, (ii) are in reasonable operating condition and repair, and (iii) are the assets used to operate the Company's Business as currently conducted.

3.7 Litigation. Except as set forth in **Schedule 3.7** hereto, and except for any Proceeding which generally affects the business of all Persons conducting business similar to the Company and the Subsidiaries and in which the Company and/or the Subsidiaries are not a named defendant, there is no Proceeding:

(a) that has been commenced by or served upon the Company, the Subsidiaries or the Shareholder, or of which the Shareholder or the Company have Knowledge; or

(b) to the Knowledge of the Company or the Shareholder, that challenges, or that will have, the effect of preventing, delaying, making illegal, or otherwise interfering with, any of the transactions contemplated hereby.

To the Knowledge of the Shareholder or the Company, no such Proceeding has been Threatened. Except as provided in **Schedule 3.7** hereto, to the Knowledge of the Shareholder or the Company, the Company and the Subsidiaries are not (individually or otherwise) a party to or subject to the provisions of any Injunction which could, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect, or impair the ability of the Shareholder to consummate the transactions contemplated hereby.

3.8 Labor Matters. Except as set forth in **Schedule 3.8** hereto, the Company and the Subsidiaries, individually or collectively, have never been a party to any collective bargaining agreement or other labor Contract and there has never been, and there is not presently pending or existing, and to the Knowledge of the Shareholder or the Company, there is not Threatened (i) any strike, slowdown, walkout, picketing, work stoppage, labor arbitration or other Proceeding in respect of the grievance of any employee, (ii) any application or complaint filed by any employee or union with the National Labor Relations Board, or any comparable Governmental Body, (iii) any organizational activity or other labor dispute against or affecting the Company or the Subsidiaries, and no application for certification of a collective bargaining agreement is pending or, to the Knowledge of the Shareholder or the Company, is Threatened. There is no lockout of any employees by the Company or the Subsidiaries and no such action is

contemplated by either the Company or the Subsidiaries. Except as set forth in **Schedule 3.8** hereto, there is no Proceeding pending or, to the Knowledge of the Shareholder or the Company, Threatened by any Person against the Company or the Subsidiaries or any of their current or former officers, directors or employees relating to employment, equal employment opportunity, discrimination, harassment, wrongful discharge, unfair labor practices, immigration, wages, hours, benefits, collective bargaining, the payment of social security or similar Taxes, occupational safety and health or plant closing.

3.9 Tax Matters.

(a) Tax Returns. The Company and the Subsidiaries have timely filed, or caused to be timely filed, or will timely file or cause to be timely filed with the appropriate taxing authorities, all Tax Returns that are required to be filed by, or with respect to, the Company and the Subsidiaries on or prior to the Closing Date. The Returns have accurately reflected and will accurately reflect all Liability for Taxes of the Company and the Subsidiaries for the periods covered thereby. **Schedule 3.9(a)** lists all income Tax Returns filed with any Governmental Body with respect to the Company and the Subsidiaries for the taxable periods ended on or after December 31, 1999.

(b) Payment of Taxes. All Taxes and Tax Liabilities of the Company and the Subsidiaries for all taxable years or periods that end on or before the Closing Date and, with respect to any taxable year or period beginning before and ending after the Closing Date, the portion of such taxable year or period ending on the day immediately preceding the Closing Date ("**Pre-Closing Period**") have been timely paid.

(c) Other Tax Matters. Except as set forth in **Schedule 3.9(c)**:

(i) the Company and the Subsidiaries have not been the subject of a dispute or claim or an audit or other examination of Taxes by the Tax authorities of any Governmental Body, nor have the Company or the Subsidiaries received any notices from any such Taxing authority relating to any issue which could have a Material Adverse Effect. **Schedule 3.9(c)** also includes a list of all Tax examination reports and statements of deficiencies assessed against or agreed to by the Company and/or the Subsidiaries since January 1, 1998, each of which has been provided to the Purchaser.

(ii) the Shareholder, the Company and the Subsidiaries have not (A) entered into an agreement or waiver or been requested to enter into an agreement or waiver extending any statute of limitations relating to the payment or collection of Taxes of the Company or the Subsidiaries, or (B) is presently contesting the Tax Liability of the Company or the Subsidiaries before any Governmental Body.

(iii) the Company and the Subsidiaries have not been included in any "consolidated," "unitary" or "combined" Tax Return provided for under Applicable Law with respect to Taxes for any taxable period for which the statute of limitations has not expired.

(iv) all Taxes which the Company or the Subsidiaries are (or have been) required by law to withhold or collect have been duly withheld or collected, and have been timely paid over to the proper authorities to the extent due and payable.

(v) neither the Company nor either of the Subsidiaries is a "United States real property holding corporation" within the meaning of Section 897(c)(2) of the Code.

(vi) there are no Tax sharing, allocation, indemnification or similar agreements in effect as between the Company and/or the Subsidiaries or any predecessor or Affiliate thereof and any other party (including the Shareholder and any predecessors or Affiliates thereof) under which the Purchaser, the Company or either of the Subsidiaries could be liable for any Taxes or other claims of any Person.

(vii) none of the Company or the Subsidiaries have applied for, been granted, or agreed to any accounting method change for which it will be required to take into account any adjustment under Section 481 of the Code or any similar provision of the Code or the corresponding Tax laws of any nation, state or locality.

(viii) no election under Section 341(f) of the Code has been made or shall be made prior to the Closing Date to treat the Company or the Subsidiaries as a consenting corporation, as defined in Section 341 of the Code.

(ix) neither the Company nor the Subsidiaries are, individually or collectively, a party to any agreement that would require any of them to make any payment that would constitute an "excess parachute payment" for purposes of Sections 280G and 4999 of the Code.

(x) there are no requests for rulings in respect of any Taxes pending between the Company or the Subsidiaries and any Tax authority.

3.10 Employee Benefits.

(a) Benefit Plans. Except as set forth in **Schedule 3.10** hereto, the Company and the Subsidiaries do not maintain or contribute to any Benefit Plans. Without limiting the generality of the foregoing provision of this Section, except as described in **Schedule 3.10** hereto, there are no pension plans, welfare plans, or any employee benefit plans qualified under Section 401(a) of the Code, to which the Company or either of the Subsidiaries are required to contribute. Except as described in **Schedule 3.10** hereto, the Company and the Subsidiaries do not and will not have any unfunded Liability for services rendered prior to the Closing Date under any Benefit Plans. The Company and the Subsidiaries are not in any material default under any Benefit Plan. Other than claims for benefits in ordinary course, there are no actions, suits, disputes, arbitrations or other material claims pending or, to the Knowledge of the Shareholder or the Company, Threatened with respect to any Benefit Plan.

(b) Employee Pension Benefit Plans. Except as set forth in **Schedule 3.10**, none of the Company, the Subsidiaries, or any Person required to be aggregated with the Company and the Subsidiaries under Section 414(b), (c), (m), or (o) of the Code ("**ERISA Affiliate**"), maintains or has ever maintained an Employee Pension Benefit Plan as defined in Section 3(2) of ERISA, that is subject to Section 412 of the Code and Section 302 of ERISA. With respect to each such Employee Pension Benefit Plan maintained or ever maintained by the Company, by either Subsidiary, or by any ERISA Affiliate: (i) no unsatisfied liabilities to participants, the IRS, the United States Department of Labor, the PBGC, or to any other Person or entity have been incurred as a result of the termination of any Employee Pension Benefit Plan, (ii) no Employee Pension Benefit Plan, which is subject to the minimum funding requirements of Part 3 of Subtitle B of Title I of ERISA or subject to Section 412 of the Code, has incurred any "accumulated funding deficiency" within the meaning of Section 302 of ERISA or Section 412 of the Code and there has been no waived funding deficiency within the meaning of Section 303 of ERISA or Section 412 of the Code, (iii) all premiums to the PBGC have been timely paid in full, and (iv) the PBGC has not instituted proceedings to terminate any such Plan and no condition exists that presents a risk that such proceedings will be instituted or that would constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any such Plan. Neither the Company nor the Subsidiaries currently sponsor, maintain, contribute to, or are required to contribute to an Employee Pension Benefit Plan subject to Title IV of ERISA.

(c) Multiemployer Plans. Except as set forth in **Schedule 3.10** hereto, neither the Company nor any of its Subsidiaries contributes to, or has or could have, any Liability (including but not limited to withdrawal Liability) with respect to any multiemployer plan (as defined in Section 4064(a) of ERISA or Section 4001(a)(3) of ERISA).

(d) Other Plans. Except as otherwise set forth in **Schedule 3.10**, there are no present or former employees of the Company or the Subsidiaries who are entitled to (i) any pensions, group health, or other benefits to be paid upon or after termination of employment, including termination on account of disability (except as otherwise required under Section 601 of ERISA), or (ii) deferred compensation payments.

(e) Documents. The Shareholder has made available to the Purchaser the following documents, as they may have been amended to the date hereof, embodying or relating to each Benefit Plan of the Company and the Subsidiaries set forth in **Schedule 3.10** hereto: (i) all written plan documents for each such Benefit Plan, including all amendments to each such Benefit Plan, any related trust agreements, group annuity contracts, insurance policies or other funding agreements or arrangements, (ii) the most recent determination letter received from the IRS, if any, as to the qualified status of any such Benefit Plan under Section 401(a) of the Code, (iii) the current summary plan description, if any, for each such Benefit Plan, and (iv) the most recent annual return/report on form 5500, 5500-C or 5500-R, if any, for each such Benefit Plan.

(f) Prohibited Transactions. The Company and the Subsidiaries have not, nor has any other "disqualified person" or "party in interest", as defined in Section 4975(e)(2)

of the Code and Section 3(14) of ERISA, respectively, engaged in a "prohibited transaction," as such term is defined in Section 4975 of the Code and Section 406 of ERISA, with respect to any Benefit Plan of the Company or any Subsidiary subject to ERISA, which could reasonably be expected to subject the Company or any Subsidiary to a Tax or penalty on prohibited transactions imposed by either Section 502(i) of ERISA or Section 4975 of the Code. The execution and delivery by the Shareholder of this Agreement and the consummation of the transactions contemplated hereby will not (i) involve any prohibited transaction within the meaning of Section 406 of ERISA or Section 4975 of the Code with respect to any Benefit Plan set forth in **Schedule 3.10** hereto, or (ii) accelerate the payment of any benefits under any Benefit Plan set forth in **Schedule 3.10** hereto.

(g) Fiduciary Duty. None of the Company, the Subsidiaries, nor any other fiduciary of any Benefit Plan set forth in **Schedule 3.10** hereto are engaged in any transaction with respect to such Benefit Plan or failed to act in a manner with respect to such Benefit Plan which could reasonably be expected to subject the Company or any Subsidiary to any material Liability for a breach of fiduciary duty under ERISA or any other Applicable Law.

(h) Group Health Plans. Except as set forth in **Schedule 3.10**, the Company, the Subsidiaries and all ERISA Affiliates have complied in all material respects with the coverage continuation requirements of all Applicable Laws, including Sections 601 through 609 of ERISA, Section 4980B of the Code, and the requirements of any similar state law regarding continued health coverage, and the Company and the Subsidiaries have incurred no material Liability with respect to its failure to offer or provide continued coverage in accordance with the foregoing requirements, nor is there any suit or other action pending, or to the Knowledge of the Shareholder or the Company, Threatened, with respect to such requirements. Except as set forth in **Schedule 3.10**, (i) there has been no violation of the obligations imposed by Section 9801 of the Code and Part 7 of Subtitle B of Title I of ERISA with respect to any Benefit Plan to which such obligations apply, (ii) none of the Company, the Subsidiaries or any ERISA Affiliate has contributed to a nonconforming group health plan (as defined in Section 5000(c) of the Code), and (iii) none of the Company, the Subsidiaries or any ERISA Affiliate has incurred a Tax under Section 5000(a) of the Code which is, or is reasonably expected to become, a Liability of the Company, the Subsidiaries or an ERISA Affiliate.

(i) Triggering of Obligation and Other Binding Commitments. Except for the claims set forth in **Schedule 3.10**, the consummation of the transactions described in this Agreement, in and of themselves, or in conjunction with any other event which has occurred on or prior to the date hereof (excluding the Retention and Severance Agreements), will not entitle any current or former employee of the Company or the Subsidiaries to severance pay, unemployment compensation or any other similar payment, or accelerate the time of payment or vesting, or increase the amount of compensation due to any such employee or former employee.

(j) Operational Compliance. Each Benefit Plan has been administered in all material respects in accordance with its terms and all Applicable Laws, and, except as set

forth in **Schedule 3.10**, each Benefit Plan intended to be qualified under Section 401(a) of the Code is so qualified and is, as most recently amended, the subject of a favorable determination letter as to its qualification. No event has occurred and no condition or set of circumstances exists in connection with which the Company or any Subsidiary could be directly or indirectly subject to any Encumbrance or loss of Tax deduction under ERISA or the Code or under any agreement, instrument, statute, rule of law or regulations pursuant to or under which the Company or any Subsidiary has indemnified or is required to indemnify any Person against any such liability (except liability for benefit claims and funding obligations payable in the ordinary course).

(k) WARN Compliance. The Company and the Subsidiaries have complied in all respects with the Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 et seq., and its corresponding regulations, and any similar state law, rule or regulation or local ordinance, rule or regulation, in each case in effect as of the date hereof, providing for notification to employees affected by closing, relocation, sale of business, mass layoff or similar event (collectively, the "**WARN Acts**") on account of closings, relocations, sales of businesses, mass layoffs or similar events occurring on or prior to the Closing and all related notices, payments, fines or assessments due to any Government Body pursuant to such WARN Acts.

(l) Absence of Termination Restrictions. Except as set forth in **Schedule 3.10**, (i) each Benefit Plan may be terminated by the Company or either Subsidiary, as applicable, in accordance with its terms and without the Company or any Subsidiary incurring any obligation or liability arising or resulting from such termination, and (ii) neither the Company, either Subsidiary nor the Shareholder has made any representations to employees of the Company or either Subsidiary that any Benefit Plan would be continued without change for any period of time on and after the Closing Date. The foregoing shall not be applicable to the Retention and Severance Agreements described in Section 3.37 and 11.8 hereof.

3.11 No Guarantees. Except as set forth in **Schedule 3.11**, (i) none of the obligations of the Company or the Subsidiaries is guaranteed by, or subject to a similar contingent Liability to, any Person, and (ii) neither the Company nor the Subsidiaries have, individually or collectively, guaranteed, or otherwise become contingently liable for, any Liability of any Person. To the Knowledge of the Shareholder or the Company, no event has arisen that would give rise to any obligation under any guarantee set forth in **Schedule 3.11** or under any of the bonds set forth in **Schedule 5.25**.

3.12 Financial Statements. The Shareholder has caused the Company and the Subsidiaries to furnish true and correct copies of the financial statements identified in **Schedule 3.12** hereto to the Purchaser. All of said financial statements, including any notes thereto, fairly present the consolidated financial position and condition of the Company and the Subsidiaries as of their respective dates and the results of their operations for the periods covered in accordance with GAAP applied by the Company and the Subsidiaries on a consistent basis throughout the periods covered thereby and on a basis consistent with that of prior years and periods; provided, however, that any unaudited and/or interim financial statements listed on such **Schedule 3.12** are subject to year-end adjustments and lack footnotes and other required

presentation items. Except for Liabilities (i) reflected or reserved against in the consolidated balance sheets (the "**Balance Sheets**") of the Company and the Subsidiaries as of December 31, 2002 (the "**Balance Sheet Date**") or in the notes thereto, (ii) incurred in the Ordinary Course of Business since the Balance Sheet Date (none of which resulted from, arose out of, is related to, or was caused by any breach of Contract), (iii) arising under Contracts entered into in the Ordinary Course of Business to which the Company or the Subsidiaries are a party, and/or (iv) set forth in **Schedule 3.12** hereto, the Company and the Subsidiaries do not have any Liabilities which, individually or in the aggregate, would have a Material Adverse Effect. The reserves reflected in the Balance Sheets are adequate.

3.13 Absence of Certain Developments. Except for the transactions contemplated by this Agreement or as otherwise set forth on **Schedule 3.13** hereto, since the Balance Sheet Date, (i) there has not been any development or combination of developments affecting the Company or the Subsidiaries of which the Shareholder, the Company or the Subsidiaries have Knowledge that has had, or is likely to have, a Material Adverse Effect, and (ii) the Company and the Subsidiaries have conducted the Business in the Ordinary Course of Business and have not:

(a) declared, set aside or paid a dividend or made any other distribution with respect to any class of capital stock of the Company or the Subsidiaries;

(b) changed accounting methods or practices (including, without limitation, any change in depreciation, amortization or cost accounting policies or rates);

(c) except as set forth in **Schedule 3.37**, entered into any employment contract or collective bargaining agreement, written or oral, or modified the terms of any existing employment contract or agreement or adopted, amended, modified or terminated any Benefit Plan;

(d) made any change or amendment in its articles of incorporation or bylaws;

(e) issued or sold any securities; acquired, directly or indirectly, by redemption or otherwise, any securities; or granted or entered into any options, warrants, calls or commitments of any kind with respect thereto;

(f) made any capital expenditure exceeding One Hundred Thousand Dollars ($100,000); and/or

(g) incurred any obligations for borrowed money or purchase money debt other than that incurred pursuant to the Debt Instruments described and set forth in **Schedule 3.29** of this Agreement.

3.14 Intellectual Property. **Schedule 3.14** hereto contains a list and description of all Intellectual Property owned by the Company and the Subsidiaries or used by the Company or the Subsidiaries in the operation of the Business. Except as set forth in **Schedule 3.14**, the Company and the Subsidiaries have all rights necessary to use such Intellectual Property, and the Shareholder and the Company have no Knowledge of any asserted claim to the effect that the operation of the Business or the possession or use in the Business of any of the Intellectual Property listed and set forth in **Schedule 3.14** hereto, infringes the Intellectual Property rights of

any other Person. Except as set forth in **Schedule 3.14**, the Shareholder and the Company have no Knowledge of any claim that any of the Intellectual Property set forth in **Schedule 3.14** is invalid; and, except as set forth in **Schedule 3.14** hereto, neither the Company nor any Subsidiary is obligated under any Contract or otherwise to pay royalties, fees or other payments with respect to any of the Intellectual Property listed and set forth in **Schedule 3.14** hereto. Except as set forth in **Schedule 3.14**, the consummation of the transactions contemplated by this Agreement will not adversely affect the use by the Company or the Subsidiaries of any of the Intellectual Property set forth in **Schedule 3.14** hereto.

3.15 Compliance with Laws. Except as set forth in **Schedule 3.15**, (i) the Business has been operated and the Company and the Subsidiaries are in compliance in all respects with the requirements of Applicable Laws to which the Company and the Subsidiaries are subject such that any lack of compliance would not have a Material Adverse Effect, and (ii) neither the Company nor the Subsidiaries have received any notice of, and neither the Shareholder nor the Company have Knowledge of, any violation of a material nature of any Applicable Laws respecting the Company or the Subsidiaries.

3.16 Operating Contracts. Except as disclosed in **Schedule 3.16** and the developer Contracts set forth in **Schedule 3.22** (the "**Developer Contracts**"), and except with respect to (i) Contracts that have been fully performed as of the date hereof and have no further force or effect, (ii) Contracts for capital expenditures having a remaining balance of Fifty Thousand Dollars ($50,000) or less, (iii) leases of personal property having a term of less than one (1) year or which require payments on an annual basis of Twenty Five Thousand Dollars ($25,000) or less per annum, (iv) Contracts for services, raw materials, supplies or equipment involving payments of Ten Thousand Dollars ($10,000) or less per annum, or (v) Contracts for the sale of any properties or services involving a value of Fifty Thousand Dollars ($50,000) or less per annum, excluding properties or services sold in the Ordinary Course of Business, the Company and the Subsidiaries are not a party to any oral or written Contract. All of the Contracts set forth in **Schedule 3.16** hereto are referred to in this Agreement as the "**Operating Contracts**." All of the Operating Contracts and the Developer Contracts were made in the Ordinary Course of Business, and, to the Knowledge of the Shareholder or the Company, are valid, binding and currently in full force and effect. Except as set forth in **Schedule 3.16** hereto, neither the Company nor the Subsidiaries are in material default under any of the Operating Contracts or the Developer Contracts, and, to the Knowledge of the Shareholder or the Company, no event has occurred which, through the passage of time or the giving of notice, or both, would constitute a default by the Company or the Subsidiaries, or give rise to a right of termination or cancellation by another party under any of the Operating Contracts or the Developer Contracts, or cause the acceleration of any Liability of the Company or the Subsidiaries, or result in the creation of any Encumbrance upon any of the properties or assets of the Company or the Subsidiaries. Except as set forth in **Schedule 3.16** hereto, to the Knowledge of the Shareholder or the Company, no other party is in default under any of the Operating Contracts or the Developer Contracts. Except as set forth in **Schedule 3.16** hereto, none of the Operating Contracts or the Developer Contracts have been canceled, terminated, amended or modified. Except as set forth in **Schedule 3.4** hereto, the consummation of the transactions contemplated hereby will not require the consent or approval of any Person under any of the Operating Contracts or the Developer Contracts.

3.17 Real Estate. With respect to real estate (including fixtures and improvements) owned by the Company or the Subsidiaries (the "**Owned Real Estate**"), and real estate (including fixtures and improvements) leased by the Company or the Subsidiaries (the "**Leased Real Estate**") (collectively, Owned Real Estate and Leased Real Estate shall be referred to herein as "**Real Estate**"):

(a) **Schedule 3.17** contains a description (including system name, county, internal identification numbers and deed and map references) segregated by each of the Company and the Subsidiaries of each parcel of Owned Real Estate and a listing and description (including the parties, term, expiration date(s), address, and the general use description of the leased premises) of each written or oral lease regarding Leased Real Estate which is not otherwise set forth in **Schedule 3.16** hereto (the leases of Leased Real Estate described in **Schedule 3.16** and **Schedule 3.17** are collectively, the "**Leases**");

(b) Except as set forth in **Schedule 3.17** hereto, there are no deferred property Taxes or assessments with respect to the Real Estate which may or will become due and payable as a result of the consummation of the transaction contemplated hereby;

(c) The Company, and each Subsidiary, respectively, is the sole owner in fee simple title of each parcel of Owned Real Estate and each such parcel is free and clear of any and all Encumbrances, except (A) those parcels of Owned Real Estate that are held in fee simple determinable, fee simple subject to condition subsequent or are held solely pursuant to easement (perpetual or otherwise), and (B) (i) those Encumbrances set forth in **Schedule 3.17** hereto, (ii) municipal zoning ordinances, recorded or platted easements for public utilities and recorded building and use restrictions and covenants, (iii) general Real Estate Taxes and installments of special assessments payable in the year of Closing, and (iv) minor survey exceptions, Encumbrances, licenses, easements or reservations of, or rights of others for, oil, gas minerals, ores or metals, rights of way, sewers, electric lines, telegraph and telephone lines and other similar purposes, or zoning or other restrictions on the use of real property, minor defects in title or other similar charges or Encumbrances not interfering in any material respect with the Ordinary Course of Business of the Company or with the use or ownership of the Owned Real Estate (collectively the "**Permitted Encumbrances**"). To the Knowledge of the Company or the Shareholder, the Permitted Encumbrances and those Encumbrances set forth in **Schedule 3.17** hereto do not individually or in the aggregate materially impair or prohibit the current use or operation of the Owned Real Estate by the Company or the Subsidiaries;

(d) Except as set forth in **Schedule 3.17** hereto, there are no condemnation Proceedings pending or, to the Knowledge of the Company or the Shareholder, Threatened with respect to all or any part of any parcel of Real Estate. **Schedule 3.17** hereto sets forth all private condemnation proceedings that have been initiated by the Company under a statutory power of condemnation granted by the North Carolina General Statutes (Chapter 40A, Section 40A-3(a)(1));

(e) To the Knowledge of the Company or the Shareholder, except for the Permitted Encumbrances and those Encumbrances set forth in **Schedule 3.17** hereto,

there are no Encumbrances which materially and adversely affect the use or occupancy of all or any part of any parcel of Owned Real Estate or any easements;

(f) Except as set forth in **Schedule 3.17** hereto, to the Knowledge of the Company or the Shareholder, the improvements located on each parcel of Real Estate, including fences, driveways and other structures occupied, used or claimed by the Company or the Subsidiaries, are wholly within the boundary lines of such parcels of Real Estate and such improvements and the present uses thereof by the Company and the Subsidiaries, as applicable, do not in any material respect infringe upon the rights of any other Person;

(g) Except as set forth in **Schedule 3.17** hereto, to the Knowledge of the Company or the Shareholder, no buildings, fences, driveways or other structures of any adjoining owner encroach, in any material respect which interferes with the operation of the Business, upon any part of any parcel of Real Estate or any easements;

(h) Except as set forth in **Schedule 3.17**, the Company and the Subsidiaries, as applicable, have all easements (or access through public utility easements) on to private property, construction permits, highway encroachment agreements and permits (and other similar licenses and permits) and right-of-way-licenses reasonably necessary to conduct the Business and to use and operate the Real Estate in the manner it is currently being used and operated by the Company and the Subsidiaries, except where the failure to have any such easements or access, construction permits, highway encroachment agreements and permits (and other similar licenses and permits), and right-of-way licenses would not have a Material Adverse Effect;

(i) Neither the Company nor any Subsidiary is in default in the performance of any material obligation under the Leases or easements, and to the Knowledge of the Company or the Shareholder, none of the other parties to the Leases or easements are in default in performance of their material obligations thereunder, the Leases and easements are in full force and effect, and neither the Company nor any of the Subsidiaries has assigned its rights under the Leases or easements;

(j) Except as set forth in **Schedule 3.17** neither the Company nor any Subsidiary has leased or granted to any other Person or entity the right to use or occupy all or any portion of the Owned Real Estate, and the Owned Real Estate is not subject to an option or right to purchase in favor of any Person or entity;

(k) Except as set forth in **Schedule 3.17**, no consents to or approval of the transactions contemplated by this Agreement are required from any Person or entity under the terms of the easements or Leases, and to the extent a consent or approval is required (each, a "**Required Consent**"), on or before Closing, the Shareholder shall, at its sole cost, obtain the Required Consent, in form reasonably satisfactory to the Purchaser; and

(l) Except as set forth in **Schedule 3.17**, each of the parcels of Owned Real Estate constitutes a separate tax parcel, and is not taxed with any other real property.

The Purchaser acknowledges and agrees that the title commitment and survey work and documentation provided in Section 5.14 of this Agreement may contain additional information regarding the Owned Real Estate of which the Shareholder does not have Knowledge as of the date of this Agreement and, as a result, may be properly included in a Supplement submitted by the Shareholder in accordance with the terms of Section 13.21 of this Agreement.

3.18 Accounts Receivable. The accounts receivable of the Company and the Subsidiaries, and other rights to the payment of money represent, and on the Closing Date will represent, valid obligations arising from sales actually made or services actually performed in the Ordinary Course of Business.

3.19 Books and Records; Bank Accounts. All of the books of account and other financial and corporate records of the Company and the Subsidiaries have been made available to the Purchaser and its representatives (or will be so made available prior to the Closing Date). Such books of account and records are current and complete in all material respects. All such books and records are consistent with the financial statements set forth in **Schedule 3.12** hereto.

3.20 Employees.

(a) **Schedule 3.20** sets forth a complete and accurate list of all the employees of the Company and each Subsidiary as of the date hereof (the "**Employees**"), together with the following information for each such Employee: name, position held, current salary, 2002 bonus, commission and incentive amounts (if any), Fair Labor Standards Act status, date of hire, current salary grade, annual vacation entitlement, accrued, but unused vacation, service date for employee benefit plan purposes, social security number, work locations and any other information the Purchaser may reasonably request. **Schedule 3.20** will indicate which Employees are not actively at work due to an approved medical, family, military, or personal leave under the policies of the Company or any Subsidiary (the "**Inactive Employees**") and, to the extent known, the date on which each Inactive Employee is expected to return to active employment. **Schedule 3.20** will be updated as of five (5) business days prior to the Closing Date and will be true and correct in all material respects as of that date.

(b) Except as set forth in **Schedule 3.20**, none of the Employees have informed the Company or either of the Subsidiaries that he/she intends to terminate employment with the Company or either of the Subsidiaries, as applicable. **Schedule 3.20** also sets forth a description of any written Contract, other than the Benefit Plans set forth in **Schedule 3.10** hereto, with respect to the conditions of employment of any of the Employees. All Employees are employed on an "at-will" basis.

(c) Except as set forth in **Schedule 3.20**, none of the Employees are working based upon a non-resident visa and the Company and the Subsidiaries have complied with their respective obligations under the Immigration Reform Control Act.

(d) Based on the Contracts to which the Company and each of the Subsidiaries is a party, neither the Company nor either of the Subsidiaries is presently subject to the requirements of Executive Order 11246.

3.21 Permits and Certificate Applications.

(a) Issued Permits. Except as set forth in **Schedule 3.21**, (i) the Company and each Subsidiary have timely obtained, or applied and meet the requirements for, all Permits of each Governmental Body, including, without limitation, the NCDEH, the NCDWQ, the NCUC and the VDH, having jurisdiction over the Company and/or the Subsidiaries, or any of their respective properties or assets, required to operate and carry on the Business as now being conducted and have timely applied to renew any such Permits for which such renewal application is required, and (ii) the Permits of the Company and the Subsidiaries are in full force and effect such that the absence of or compliance with the requirements of any such Permit, restrictions upon or lack of force or effect of any such Permits (either obtained or applied for) would not have a Material Adverse Effect. Neither the Company nor the Subsidiaries have received notice that any Permit is being considered for non-renewal, termination, revocation or suspension.

(b) Permit Applications. The Company and/or the Subsidiaries have several pending applications for Permits and Permit extensions pending before Governmental Bodies, including the NCUC and the VDH, as set forth in **Schedule 3.21**, for their respective water and/or wastewater utility system extension(s). In connection therewith, the Person applying for every Permit certificate may be required to post a performance or other bond, which posted bonds are included in **Schedule 5.25** of this Agreement (or a Supplement thereto).

3.22 Developer Contracts. Except for Contract agreements which have no further executory obligations other than compliance with Applicable Laws, or which are terminated or expired, **Schedule 3.22** sets forth the agreements with developers to which either the Company and/or the Subsidiaries are a party, including (i) agreements for installation and acquisition by the Company or any Subsidiary of new water and/or wastewater utility systems which require future payments by the Company or any Subsidiary to certain developers based upon prospective customer/system connections, and (ii) agreements whereby the developer has reserved portions of water and wastewater utility systems production facility capacity for the period of years specified in the applicable Contract.

3.23 Subsidiaries. Except for the Subsidiaries, the Company has no subsidiaries and does not own any shares of stock or other securities or equity interests, directly or indirectly, in any other Person. Except as disclosed or described in this Agreement or as set forth in **Schedule 3.23** hereto, the Company is not subject to any obligation or requirement to provide funds to, or invest in, any such Person.

3.24 Insurance.

(a) The Shareholder, the Company and the Subsidiaries, as applicable, have individually or jointly maintained, and will continue to maintain until the Closing Date, the insurance set forth in **Schedule 3.24**, which insurance covers some of the tangible real and personal property and assets of the Company and the Subsidiaries, whether owned or leased, against loss or damage by fire or other casualty. All such insurance is in full force

on the date of this Agreement and is either self-insured or carried with insurers licensed in the states affected by such policies.

(b) The Company and the Subsidiaries are presently insured for general liability, vehicle liability and worker's compensation risks through a third party insurance company, which insurance covers claims made against the Company or any Subsidiary related to occurrences arising on or after February 1, 2003.

(c) The Company and the Subsidiaries have in the past self-insured for general liability, vehicle liability and worker's compensation risks with a pool of entities through ALLETE, Inc., which self-insurance covers claims made against the Company or any Subsidiary related to occurrences arising prior to February 1, 2003.

(d) The Company and the Subsidiaries do not maintain, and have not in the past maintained, any form of environmental insurance coverage.

(e) The Company and the Subsidiaries have promptly and adequately notified the insurance carriers of any and all claims known with respect to the operations, products or services of the Company or the Subsidiaries for which the Company or the Subsidiaries are insured and no insurance carrier has denied coverage or reserved its rights with respect to such claims. The Company and the Subsidiaries have not been refused any insurance coverage by any insurance carrier to which they, individually or collectively, have applied for insurance during the past three (3) years.

3.25 Brokers. Except for the engagement of UBS Securities LLC by the Shareholder, neither the Company, the Subsidiaries, the Shareholder nor their respective Affiliates has employed or engaged any broker, finder, agent, banker or third party, nor have they otherwise dealt with anyone purporting to act in the capacity of a finder or broker in connection with the transactions contemplated hereby. No commissions, finder's fees or like charges have been or will be incurred by the Company or the Subsidiaries in connection with the execution and delivery of this Agreement or the consummation of the transactions contemplated hereby. Any such commissions, finders' fees or like charges shall be directly chargeable to and will be paid by the Shareholder as contemplated by the terms of this Agreement.

3.26 Relationship with Related Persons. Except as set forth in **Schedule 3.26** hereto, and except for benefits set forth in **Schedule 3.10**, the Shareholder, directors, officers, and employees of the Company and the Subsidiaries, and their Related Persons do not have any interest in any of the properties or assets of or used by the Company or the Subsidiaries and do not own, of record or as a beneficial owner, an equity interest or any other financial or profit interest in any Person that (i) has had business dealings or a material financial interest in any transaction with the Company or the Subsidiaries or, (ii) has engaged or is engaged in competition with the Company or the Subsidiaries with respect to any line of products or services of the Company or the Subsidiaries in any market presently served by the Company or the Subsidiaries (a "**Competing Business**") (except for less than five percent (5%) of the outstanding capital stock of any Competing Business that is publicly traded on any recognized exchange or in the over-the-counter market). To the Knowledge of the Company or the Shareholder, and except as set forth in **Schedule 3.26** hereto, neither the Shareholder, nor any

director or officer of the Company or any Subsidiary, and none of their Related Persons, is a party to any Contract with, or has any claim or right against, the Company or the Subsidiaries, other than the rights the officers and directors of the Company and the Subsidiaries have with respect to indemnification under state law. All money owed by the Company and the Subsidiaries to their respective shareholders, directors or officers, or their Related Persons, (other than for salary) are for bona fide debts and are set forth in **Schedule 3.26** hereto.

3.27 Internal Disclosure Controls and Procedures. ALLETE, Inc. has established and maintains disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended); such disclosure controls and procedures are designed to ensure that material information relating to the Company and the Subsidiaries is made known to ALLETE, Inc.'s Chief Executive Officer and its Chief Financial Officer by others within those entities, and such disclosure controls and procedures are effective to perform the functions for which they were established; ALLETE, Inc.'s auditors and the Audit Committee of ALLETE, Inc.'s Board of Directors have been advised of: (i) any significant deficiencies and/or material weaknesses in the design or operation of internal controls which could adversely affect the Company's and/or the Subsidiaries' ability to record, process, summarize, and report financial data, and (ii) any fraud, whether or not material, that involves Senior Management Employees or other employees of ALLETE, Inc. and/or its Subsidiaries who have a significant role in ALLETE, Inc.'s internal control over financial reporting; and since the date of the most recent evaluation of such disclosure controls and procedures, there have been no changes in internal control over financial reporting or in other factors that could materially affect internal control over financial reporting.

3.28 Environmental Matters. Except as set forth in **Schedule 3.28** and except as would not have a Material Adverse Effect, the Company and its Subsidiaries: (i) have not transported, stored, and/or disposed of any Hazardous Materials handled by the Company and its Subsidiaries, (ii) do not have Knowledge (including Knowledge by the Shareholder) that the Real Estate is now being used, or has ever been used, as a landfill, dump or other disposal, storage, transfer, treating or handling area for any Hazardous Materials, (iii) do not have Knowledge (including Knowledge by the Shareholder) that asbestos, "**PCBs**" (polychlorinated biphenyls) or urea formaldehyde has been placed, stored, located, or disposed on the Real Estate, (iv) excluding storage tanks (whether underground or above ground) which are and have been utilized solely for storage of potable water, do not have Knowledge (including Knowledge by the Shareholder) that there are currently or ever have been any underground and/or above ground storage tanks (whether or not currently in use) on the Real Estate, (v) do not have Knowledge (including Knowledge by the Shareholder) that the Real Estate contains Hazardous Materials that require remediation under Environmental Laws, and (vi) have not agreed to assume and, to the Knowledge of the Company or the Shareholder, have not assumed by operation of law, any environmental Liability of any other Person. Except as set forth in **Schedule 3.28** hereto, the Real Estate is not listed on the National Priorities List, the Comprehensive Environmental Response Compensation and Liability Information System, the Resource Conservation and Recovery Information System or any other governmental list of potentially contaminated properties.

3.29 Debt Instruments. **Schedule 3.29** is a true, correct and complete list showing the names of the parties and outstanding indebtedness as of the respective dates set forth in

Schedule 3.29 under all mortgages, indentures, notes, guarantees and other obligations for or relating to borrowed money, purchase money debt (including conditional sales contracts and capital leases) or covenants not to compete (the "**Debt Instruments**") for which the Company or a Subsidiary is primarily or secondarily obligated. The Shareholder has previously delivered to the Purchaser true, complete and correct copies of each of the Debt Instruments, other than the increase in the CoBank, ACB line of credit described in Section 5.26. Except as described in **Schedule 3.29**, the Company and each Subsidiary have performed all of the material obligations required to be respectively performed by them, and are not in material default under any of the provisions of any of the Debt Instruments, and there has not occurred any event which, (with or without notice, lapse of time or the happening or occurrence of any other event) would constitute such a default.

3.30 Customers and Suppliers. Except as set forth in **Schedule 3.30**, (i) to the Knowledge of the Company or the Shareholder, and except in the Ordinary Course of Business, no material customer, subscriber or a material (in the aggregate) group of customers or subscribers of the Company or the Subsidiaries have notified the Company or any Subsidiary on or after the Balance Sheet Date, that the customer intends to terminate, cancel, limit or modify their business relationship with the Company or any Subsidiary, except such terminations, cancellations, limitations or modifications as occur in the Ordinary Course of Business of the Company or the applicable Subsidiary, and (ii) no vendor or supplier of the Company or a Subsidiary which is material to the Business has notified the Company or any such Subsidiary after the Balance Sheet Date, that it intends to terminate, cancel, limit or modify its business relationship with the Company or the applicable Subsidiary in any material respect.

3.31 Shareholder Loans. Except as set forth in **Schedule 3.31**, there are no loans, advances or other obligations for borrowed money owing by the Company or the Subsidiaries to the Shareholder or its Affiliates (other than the Company and the Subsidiaries) as of the date hereof. Except as set forth in **Schedule 3.31**, the Shareholder and its Affiliates (other than the Company and the Subsidiaries) do not have any claim of any kind against the Company or the Subsidiaries.

3.32 Adequacy of Properties. Except as set forth in **Schedule 3.32**, the Company and each Subsidiary, respectively, owns, leases or otherwise has adequate rights to use the tangible and intangible personal property necessary for the conduct of their Business in the manner in which such Business is presently being conducted with no material conflict with or infringement of the rights of others such that the absence of such ownership or rights could not reasonably be expected to have a Material Adverse Effect.

3.33 Absence of Certain Business Practices. Except as disclosed in **Schedule 3.33**, none of the Company, the Subsidiaries nor any Person acting on their behalf has, directly or indirectly, within the past six (6) years given or agreed to give any gift or similar benefit to any customer, supplier, governmental employee or other Person who is or may be in a position to help or hinder the Business of the Company or a Subsidiary (or assist the Company or a Subsidiary in connection with any actual or proposed transaction) which (i) might subject the Company or a Subsidiary to any damage or penalty in any civil, criminal or governmental litigation or Proceeding, (ii) if not given in the past, might have had a Material Adverse Effect, or

(iii) if not continued in the future, could reasonably be expected to have a Material Adverse Effect.

3.34 Trade Regulation. Except as set forth in **Schedule 3.34**, (i) all of the prices charged by the Company and the Subsidiaries in connection with the marketing, sale or distribution of services have been in compliance with all Applicable Laws, and (ii) no claims have been communicated or, to the Knowledge of the Company or the Shareholder, Threatened against the Company or the Subsidiaries with respect to wrongful termination of any third party independent contractor, discriminatory pricing, price fixing, unfair competition, false advertising, or any other violation of any Applicable Laws relating to anti-competitive practices or unfair trade practices of any kind, and to the Knowledge of the Company or the Shareholder, no specific situation, set of facts, or occurrence provides any basis for any such claim.

3.35 Shareholder Ownership of the Stock. The Shareholder represents and warrants that the Shareholder is the lawful owner of 6,000 shares of Stock, free and clear of all Rights and Encumbrances. The Shareholder has the full legal right, power and authority to enter into this Agreement and to sell, assign, transfer and convey the shares of Stock so owned by the Shareholder pursuant to this Agreement, and the delivery to the Purchaser of the Stock pursuant to the provisions of this Agreement will transfer to the Purchaser good title thereto, free and clear of all Rights and Encumbrances.

3.36 Virginia Operations. The operations of the Company in the Commonwealth of Virginia consist solely of two (2) water systems located in Carroll County, Virginia. These water systems are subject to the oversight and regulation of VDH.

3.37 Employee Retention. On or about the date hereof, the Company and the Subsidiaries have entered into certain legal, binding and enforceable retention and severance agreements in the form of **Exhibit D** hereto (the "**Retention and Severance Agreements**") with their respective employees as set forth in **Schedule 3.37** to this Agreement, which agreements entitle such employees to, among other things, one or more retention payments (the "**Retention Payment**") by their applicable employer entity in the event, among other things, of their continued employment to and on the Closing Date. Promptly following the date of this Agreement, the Shareholder shall deliver to the Purchaser true, complete and correct copies of each Retention and Severance Agreement that is executed and delivered by the Company and its Subsidiaries. **Schedule 3.37** also sets forth the Retention Payment that may become payable pursuant to the Retention and Severance Agreements to each such employee in the event the employee complies with the terms of the retention provisions of the Retention and Severance Agreement. The Shareholder represents and warrants that it shall concurrently at and upon the Closing, (i) provide and remit to the Company and the Subsidiaries funds sufficient to pay (x) any interim payments on or for a Retention Payment obligation, (y) any remaining Retention Payment obligations, if not previously paid, as such exist, in the sole discretion of the Shareholder as provided in the Retention and Severance Agreements, on the Closing Date, and (z) any applicable employment taxes associated therewith, and (ii) cause the Company and the Subsidiaries to make the required Retention Payment on the Closing Date in accordance with the terms of the Retention and Severance Agreements.

3.38 Regulation as Utilities. The Company and the Subsidiaries are regulated as public utilities in North Carolina, and the Company is also regulated as a public utility in Virginia. Neither the Company, the Subsidiaries nor any "subsidiary company" or "affiliate" (as such terms are defined in the Public Utility Holding Companies Act of 1935, as amended) of the Shareholder is subject to regulation as a public utility or public service company (or similar designation) by any other state in the United States, by the United States or any agency or instrumentality of the United States or by any foreign country.

3.39 Limitation on Representations and Warranties. Except for the representations and warranties contained in this Article III, neither the Shareholder, the Company, the Subsidiaries nor any of their Affiliates, nor any other Person acting on behalf of the Shareholder, the Company, the Subsidiaries or any of their Affiliates, makes any representation or warranty, express or implied, concerning, without limitation, the Stock, the Business, the Company and its Subsidiaries or any other matter.

3.40 Internal Accounting Controls. The Company and each Subsidiary maintains a system of internal accounting controls sufficient to provide reasonable assurances that in all material respects: (i) transactions are executed in accordance with the general or specific authorization of Senior Management Employees, (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain accountability for assets, (iii) access to assets is permitted only in accordance with the general or specific authorization of Senior Management Employees, and (iv) the recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

3.41 Water Quality. Except as set forth in **Schedule 3.41** hereto, the quality of the drinking water supplied by the Company and the Subsidiaries to their respective customers is in compliance with the maximum contaminant levels for primary contaminants established by the Safe Drinking Water Act, as amended, the U.S. Environmental Protection Agency, DEH (for North Carolina only), and VDH (for Virginia only), in effect, defined, interpreted and enforceable on the date hereof. Specifically excluded from this representation and warranty are any secondary drinking water standards and all maximum contaminant levels not in effect and enforceable on the date of the execution of this Agreement, including the promulgated but not yet effective and enforceable Groundwater Rule, Radionuclide Rule and Disinfectant/Disinfection Byproducts Rule.

ARTICLE 4

REPRESENTATIONS AND WARRANTIES OF THE PURCHASER

As an inducement for the Shareholder to enter into this Agreement and to consummate the transactions contemplated hereby, the Purchaser represents and warrants to the Shareholder that each and all of the following representations and warranties (as modified by the Schedules and any Supplement delivered by the Purchaser pursuant to Section 13.21 of this Agreement) are true and correct as of the date of this Agreement and will be true and correct as of the Closing Date. The Schedules shall be arranged in paragraphs corresponding to the sections and subsections contained in this Article 4.

4.1 Organization. The Purchaser is a corporation duly organized, validly existing and in good standing under the laws of the Commonwealth of Pennsylvania and has all requisite power and authority, corporate and otherwise, to own, operate and lease its properties and assets and to conduct its business as it is now being conducted. The Purchaser is duly qualified to transact business as a foreign corporation and is in good standing under the laws of every state or jurisdiction in which the nature of its activities or of its properties owned, leased or operated makes such qualification necessary and in which the failure to be so qualified could reasonably be expected to have a Material Adverse Effect on the Purchaser.

4.2 Due Authorization. The execution, delivery and performance of this Agreement and the Ancillary Documents to be executed and delivered by the Purchaser pursuant to this Agreement, and the consummation of the transactions contemplated hereby and thereby have been duly and validly authorized by all necessary corporate action on the part of the Purchaser. This Agreement and the Ancillary Documents have been, or will be on or before the Closing Date, duly and validly authorized, executed and delivered by the Purchaser and the obligations of the Purchaser hereunder and thereunder are or will be, upon such execution and delivery, valid, legally binding and enforceable against the Purchaser in accordance with their respective terms.

4.3 No Breach. The Purchaser has full power and authority, corporate and otherwise, to purchase the Stock being purchased hereunder and to otherwise perform its obligations under this Agreement and the Ancillary Documents to be executed and delivered by the Purchaser pursuant hereto. The execution and delivery of this Agreement and the Ancillary Documents to be executed and delivered by the Purchaser pursuant to this Agreement, and the consummation of the transactions contemplated hereby and thereby will not: (i) violate any provision of the Articles of Incorporation or Bylaws (or comparable governing documents or instruments) of the Purchaser, (ii) violate any Applicable Laws or Injunction applicable to the Purchaser, (iii) other than filings and approvals required to comply with Applicable Laws, including (A) any filing required by HSR, and (B) applicable requirements of the NCUC, the VDH and/or any Governmental Body, require any filing with, Permits from, authorization, consent or approval of, or the giving of any notice to, any Person, (iv) result in a violation or breach of, or constitute (with or without due notice or lapse of time or both) a default (or give another party any rights of termination, cancellation or acceleration) under, any of the terms, conditions or provisions of any note, bond, mortgage, indenture, license, franchise, Permit (including, but not limited to, any Permits, appeals or authorizations of any Governmental Body), lease or other Contract to which the Purchaser is a party, or by which it or any of its assets or properties may be bound.

4.4 Investment Representations. The Purchaser understands that the Stock has not been registered under the Securities Act, or under the securities laws of any jurisdiction, by reason of reliance upon certain exemptions.

4.5 Brokers. The Purchaser has not employed or engaged any broker, finder, agent, banker or third party, nor has it otherwise dealt with anyone purporting to act in the capacity of a finder or broker, in connection with the transactions contemplated hereby.

ARTICLE 5

PERFORMANCE AND COVENANTS PENDING CLOSING

The Shareholder covenants and agrees that from and after the date of this Agreement and until the earlier of the Closing Date or the termination of this Agreement in accordance with Article 12 hereof:

5.1 Continuing Due Diligence. At the request of the Purchaser, the Shareholder shall, from time to time, give or cause to be given to the Purchaser, its officers, employees, counsel, accountants and other representatives, upon reasonable notice to the Shareholder, reasonable access during normal business hours, without undue disruption to the Business of the Company or any Subsidiary, to the properties and assets and all of the books, minute books, title papers, records, files, Contracts, insurance policies, environmental records and reports, licenses and documents of every character solely to conduct continuing due diligence investigations of the Company and the Subsidiaries relating to the Business for the purpose of monitoring the Business until and through the Closing Date and to plan for transitional matters after the Closing. For these purposes, the Shareholder shall furnish or cause to be furnished to the Purchaser, its officers, employees, counsel, accountants and other representatives the information with respect to the properties or assets of the Company and the Subsidiaries as any of them may reasonably request. The Purchaser, its officers, employees, counsel, accountants and other representatives shall have the authority to interview, as reasonably necessary and without undue disruption to the Business of the Company or any Subsidiary, all employees, customers, vendors, suppliers and other parties having relationships with the Company and/or the Subsidiaries, and the Shareholder shall make such introductions as may be requested; provided, however, that access to customers for investigatory purposes shall, if granted by the Shareholder, be undertaken in a commercially reasonably manner consistent with the best interests of the Company and the Subsidiaries and shall be subject to the prior consent of the Shareholder, which consent shall not be unreasonably withheld.

5.2 Conduct of Business. The Shareholder shall cause the Company and the Subsidiaries to carry on their respective Business diligently, only in the Ordinary Course of Business and substantially in the same manner as heretofore conducted. The Company and the Subsidiaries shall not make any regulatory filings with any Governmental Body, except in the Ordinary Course of Business or with the prior written consent of the Purchaser (which consent shall not be unreasonably withheld, delayed or conditioned). The Shareholder shall cause the Company and each Subsidiary to provide to the Purchaser copies of each such regulatory filing made by the Company or such Subsidiary. The Shareholder shall not cause or permit any amendment of the Articles of Incorporation or Bylaws of the Company or any Subsidiary (or other governing instrument).

5.3 Encumbrances. The Shareholder shall not, directly or indirectly, perform or fail to perform any act which would result in the creation or imposition of any Encumbrance on any of the properties or assets of the Company or any Subsidiary, or otherwise adversely affect the marketability of the Company's or a Subsidiary's title to any of its properties or assets, outside of the Ordinary Course of Business.

5.4 Pay Increases. Except for payments pursuant to the Retention and Severance Agreements and normal increases in the Ordinary Course of Business, the Shareholder shall not permit the Company or a Subsidiary, and the Company and the Subsidiaries shall not, without the prior written consent of the Purchaser, grant any increase in the salaries or rate of pay to any of its employees, grant any increase in any benefits or establish, adopt, enter into, make any new grants or awards under, or amend any collective bargaining agreement, employment agreement or Benefit Plan for the benefit of any of its employees.

5.5 Restrictions on New Contracts. Except with the prior written consent of the Purchaser, which consent shall not be unreasonably withheld, delayed or conditioned, the Shareholder shall not permit the Company and the Subsidiaries to, and the Company and the Subsidiaries shall not, enter into any Contract, incur any Liability, assume, guarantee or otherwise become liable or responsible for any Liability of any other Person, make any loans, advances or capital contributions to any other Person (except for extensions of credit to its customers in the Ordinary Course of Business), or waive any right or enter into any other transaction, in each case other than in the Ordinary Course of Business and consistent with normal business practices of the Company and the Subsidiaries. Without limiting the foregoing, for the purposes of this Agreement, any Contract other than Contracts for capital improvements described in Section 5.17 hereof involving the sum of One Hundred Thousand Dollars ($100,000) or more shall be deemed to be outside the Ordinary Course of Business; provided, however, for purposes of this Agreement, Developer Contracts involving a purchase price paid by the Company or any Subsidiary of Seventy-five Thousand Dollars ($75,000) or less shall be considered to have been entered into in the Ordinary Course of Business.

5.6 Preservation of Business. The Shareholder shall use commercially reasonable efforts (i) to preserve intact the Business of the Company and the Subsidiaries, (ii) to keep available to the Purchaser the Employees, and (iii) to preserve for the Purchaser the present goodwill and relationship of the Company and the Subsidiaries with their respective vendors, suppliers, customers and others having business relationships with the Company and the Subsidiaries.

5.7 Payment and Performance of Obligations. The Company and the Subsidiaries shall, and the Shareholder shall cause the Company and the Subsidiaries to, timely pay and discharge all invoices, bills and other monetary Liabilities.

5.8 Restrictions on Sale of Assets. Except for sales or transfers contemplated on the date of this Agreement and set forth in **Schedule 5.8**, the Shareholder shall not permit the Company and the Subsidiaries to, and the Company and the Subsidiaries shall not, sell, assign, transfer, lease, sublease, pledge or otherwise encumber or dispose of any of its properties or assets, except for the provision of services in the Ordinary Course of Business and at regular prices.

5.9 Prompt Notice. The Shareholder and the Purchaser shall promptly notify the other in writing upon becoming aware of any of the following: (i) any claim, demand or other Proceeding that may be brought, Threatened, asserted or commenced against the Company or any Subsidiary or the Purchaser, or their respective officers or directors, (ii) any changes in the accuracy of the representations and warranties made by the Shareholder or the Purchaser in this

Agreement, (iii) any Injunction or any complaint praying for an Injunction restraining or enjoining the consummation of the transactions contemplated hereby, or (iv) any notice from any Person of its intention to institute an investigation into, or institute a Proceeding to restrain or enjoin the consummation of the transactions contemplated hereby or to nullify or render ineffective this Agreement or such transactions if consummated.

5.10 Consents. As soon as reasonably practicable and in any event on or before the Closing Date, the Shareholder and the Purchaser shall work cooperatively and will use commercially reasonable efforts to obtain or cause to be obtained all of the consents and approvals of all Persons necessary to consummate the transactions contemplated hereby, including the consents and approvals set forth in **Schedule 3.4** hereto.

5.11 Copies of Documents. The Shareholder has furnished or made available to the Purchaser a true, complete and accurate copy of each Operating Contract set forth in **Schedule 3.16** hereto and any Developer Contract set forth in **Schedule 3.22** hereto.

5.12 No Solicitation of Other Offers. The Shareholder, the Company and the Subsidiaries will not, and will not permit their respective representatives, investment bankers, agents and Affiliates of any of the foregoing to, directly or indirectly, (i) solicit or encourage submission of or any inquiries, proposals or offers by, (ii) participate in any negotiations with, (iii) afford any access to the properties, books or records of the Company or the Subsidiaries, (iv) accept or approve, or (v) otherwise assist, facilitate or encourage, or enter into any Contract with, any Person or group (other than the Purchaser and its Affiliates, agents and representatives), in connection with any Acquisition Proposal. In addition, the Shareholder, the Company and the Subsidiaries will not, and will not permit their respective representatives, investment bankers, agents and Affiliates of any of the foregoing to, directly or indirectly, make or authorize any statement, recommendation or solicitation in support of any Acquisition Proposal made by any Person or group (other than the Purchaser). In addition, the Shareholder shall immediately cease, and shall cause the Company and the Subsidiaries to immediately cease, any and all existing activities, discussions or negotiations with any parties with respect to any of the foregoing.

5.13 Accounts Receivable and Payable. Except for payments to the Shareholder or its Affiliates (other than the Company and the Subsidiaries), the Company and the Subsidiaries shall not, and the Shareholder shall not cause the Company or any Subsidiary to, accelerate the collection of its accounts receivable or delay the payments of its accounts payable or other Liabilities, in each case arising out of the operation of the Business in a manner which would be inconsistent with past practice.

5.14 Title Matters; Surveys.

(a) Title Documents. As soon as practicable following the execution of this Agreement, the Shareholder, at its sole cost, shall provide to the Purchaser: (i) a current A.L.T.A. Form 1992 title insurance commitment, with extended coverage endorsements, from a title insurance company reasonably acceptable to the Purchaser (or if there is an existing title policy ("**Existing Policy**") for such parcel issued by a title insurance company reasonably acceptable to the Purchaser, from such title insurance company) for

the parcel of Owned Real Estate which serves as the Cary, North Carolina operations center of the Company and which is more fully described in **Schedule 3.17** of this Agreement ("**Cary Property**") agreeing to insure the title of the owner in amounts reasonably satisfactory to the Purchaser for such parcel, but in no event in excess of an insurable amount reasonably determined by the title insurance company, with standard exceptions waived, together with copies of all documents mentioned in said title insurance commitment, as well as a copy of the Existing Policy, if any, and (ii) a current-on-the-ground ALTA survey for the Cary Property, prepared by a reputable licensed surveyor in the State of North Carolina, containing a certification in form reasonably satisfactory to the Purchaser, in favor of the Purchaser, the title insurance company and the owner of the Cary Property (collectively, with the items described in clause (i), the "**Title Documents**").

(b) Review of Title Documents. The Purchaser shall be allowed twenty (20) days after receipt of the Title Documents for examination thereof and the making and delivering of any written objections to the condition of title. If no title objection is made within such period, any objection shall be deemed to have been waived by the Purchaser. If there is a written objection to the condition of title to the Cary Property and such objection is made by the Purchaser within said twenty (20) day period, the Shareholder shall use commercially reasonable efforts, at its sole cost and expense, to cure said title objections within thirty (30) days after said objections have been raised by the Purchaser. If the Purchaser's title objections are not cured or endorsed over to the Purchaser's reasonable satisfaction within such thirty (30) day period, then the Purchaser shall have the right for a period of five (5) business days following the termination of such thirty (30) day cure period, (i) to terminate this Agreement by giving written notice of termination to the Shareholder, or (ii) if there is a title objection that can be stated in monetary terms, and if the Shareholder and the Purchaser mutually agree to such monetary terms, the Purchaser may accept the title objection and the Purchase Price shall be reduced by the mutually agreed upon amount. If the Purchaser does not exercise its right to terminate or if the parties cannot agree upon a reduction of the Purchase Price, the Purchaser shall be deemed to have waived all such uncured objections to the condition of title disclosed by the Title Documents. The title matters approved or deemed approved by the Purchaser pursuant to this Section 5.14(b) are referred to as "**Permitted Exceptions**").

(c) Title Policy. It shall be a condition to the Purchaser's obligations to close the transactions contemplated herein that the Shareholder shall, at Closing, cause the title insurance company approved by the Purchaser pursuant to Section 15.4(a), to issue and deliver to the Purchaser (i) an ALTA owners extended coverage policy of title insurance on the 1970 form (or 1992 form, so long as all creditors rights, fraudulent conveyance and other similar exceptions are deleted), in an amount satisfactory to the Purchaser, showing title to the Cary Property vested in the Company and/or applicable Subsidiary, subject only to the Permitted Exceptions, and containing such endorsements as may be reasonably required by the Purchaser (the "**Title Policy**"), or (ii) if there is an Existing Policy from a title insurance company satisfactory to the Purchaser, an endorsement or endorsements to the Existing Policy in each case in form reasonably satisfactory to the Purchaser, increasing the liability amounts thereunder to an amount satisfactory to the

Purchaser, but in no event in excess of an insurable amount reasonably determined by the title insurance company. The Purchaser shall be responsible for paying the costs of the foregoing and providing the title insurance company with such documentation and indemnifications as may be reasonably required to issue such coverage.

(d) Other Owned Real Estate. In addition to the Cary Property, the Company and the Subsidiaries own approximately nine hundred fifty (950) water well lots, thirty-three (33) wastewater treatment plant lots, fourteen (14) elevated tank lots, and approximately eighty (80) wastewater pump (lift) station lots. While most of these properties are either (i) owned in fee simple absolute title (with several titled in fee simple determinable or fee simple subject to a condition subsequent), or (ii) are leased, some of the properties, as indicated, have perpetual easements only. The Shareholder shall be under no obligation pursuant to the terms of this Agreement to provide any title commitment, title insurance, survey or other documentation to the Purchaser unless such documentation is presently available in the files of the Shareholder, the Company or the Subsidiaries.

5.15 Insurance. The Shareholder shall maintain in full force and effect, for the benefit of the Company and the Subsidiaries, all insurance coverages for the Company and the Subsidiaries substantially comparable to coverages existing on the date hereof.

5.16 Filing Reports and Making Payments. The Company and the Subsidiaries shall, and the Shareholder shall cause the Company and the Subsidiaries to, timely file all required reports and notices with applicable Governmental Bodies and timely make all uncontested payments due and owing to each such Governmental Body, including, but not by way of limitation, any filings, notices and/or payments required by reason of the transactions contemplated by this Agreement.

5.17 Capital Expenditures. The Company and the Subsidiaries shall not, and the Shareholder shall not permit the Company or any Subsidiary to, make any capital expenditures in excess of its approved capital expenditures budget (which has been previously provided to the Purchaser) without the Purchaser's prior written consent, which consent shall not be unreasonably withheld, delayed or conditioned.

5.18 Monthly and Year-End 2003 Financials. Within fifteen (15) days of the close of each month after the execution of this Agreement by all parties hereto, the Shareholder shall deliver to the Purchaser a consolidated balance sheet and income statement for the Company and the Subsidiaries disclosing the financial position and results of operations of the Company and the Subsidiaries for the preceding month and year-to-date which shall be prepared on a basis consistent with the interim financial statements of the Company and the Subsidiaries, and consistent with the prior months and year-to-date financial statements. At least ten (10) days prior to Closing, the Shareholder shall deliver to the Purchaser audited consolidated financial statements, including a balance sheet and income statement, for the Company and the Subsidiaries which, including any notes thereto, fairly present the consolidated financial position and condition of the Company and the Subsidiaries as of December 31, 2003 and the results of their operations for the period then ended in accordance with GAAP applied by the Company and the Subsidiaries on a consistent basis throughout the periods covered.

5.19 Litigation. From the date hereof and through the Closing Date, the Shareholder will notify the Purchaser in writing of any actions or Proceedings of the type required to be described in Section 3.7 of this Agreement, that, from the time hereof, are, to the Knowledge of the Shareholder or the Company, Threatened or commenced against the Company or either Subsidiary or against any officer, director or Employee of the Company or either Subsidiary.

5.20 Notification of Inaccuracy. The Shareholder agrees to promptly notify the Purchaser in writing of any material inaccuracy made by the Shareholder in this Agreement of which the Shareholder becomes aware prior to the Closing Date and which could result in a Material Adverse Effect. The Purchaser agrees to promptly notify the Shareholder in writing of any material inaccuracy made by the Purchaser in this Agreement of which the Purchaser becomes aware prior to the Closing Date. The foregoing shall not limit the ability of the Shareholder to Supplement the Schedules.

5.21 Debt Instruments. The Shareholder has provided the Purchaser with copies of all Debt Instruments of the Company and the Subsidiaries which are described in Section 3.29 of this Agreement and which are set forth in **Schedule 3.29**. Upon payment of the Purchase Price at the Closing, any and all indebtedness of the Company and the Subsidiaries to ALLETE, Inc., the Shareholder and/or any of their Affiliates shall be deemed paid in full.

5.22 Guarantees.

(a) Company and Subsidiary Guarantees. All guarantees set forth in **Schedule 3.11** hereof and all other guarantees made by the Company or the Subsidiaries, contingent or otherwise, of any kind or nature made for or on behalf of ALLETE, Inc., the Shareholder, any Affiliate of ALLETE, Inc. or the Shareholder (other than the Company and the Subsidiaries), or any of their respective officers, directors, employees or other representatives shall be fully and finally terminated, without recourse, and delivered to the Purchaser at and upon the Closing.

(b) Shareholder and Affiliate Guarantees. **Schedule 5.22(b)** sets forth a list of guarantees made by the Shareholder and/or its Affiliates (excluding the Company and the Subsidiaries) with respect to the Business. Each of the parties shall use all commercially reasonable efforts prior to the Closing to cause the Shareholder and its Affiliates to be released from any and all such guarantees, contingent or otherwise, of any kind or nature, made for or on behalf of the Company or any of the Subsidiaries (each a "**Shareholder Guarantee**"). The release of the Shareholder Guarantee(s) shall be evidenced by the return of the original guarantee at the Closing or by delivery of an irrevocable release executed by the named guarantee or beneficiary of the Shareholder Guarantee. In the event that such a release is not obtained at or prior to the Closing, the Purchaser, the Company and the Subsidiaries shall make continuous commercially reasonable efforts to terminate, extinguish or otherwise obtain the release of any such remaining Shareholder Guarantee(s) (along with all documents and instruments to evidence such binding termination extinguishment or release). In furtherance of the foregoing, the Purchaser shall defend, indemnify and hold the Shareholder and its Affiliates harmless from and against any Shareholder and/or Affiliate Guarantee.

5.23 Environmental Assessment. The Shareholder shall permit and cooperate with the Purchaser or any reasonably qualified environmental consultant designated by the Purchaser (the "**Environmental Assessment Firm**") to conduct a Phase I environmental site assessment (the "**Environmental Assessment**") of any Owned Real Estate or other Real Estate used in the Business prior to the Closing. The Purchaser shall pay all fees and expenses of the Environmental Assessment Firm. Any and all written report(s) of the Environmental Assessment Firm shall be concurrently delivered to the Shareholder with and upon the delivery of such report(s) to the Purchaser. The Shareholder shall have the right to Supplement its Schedules to this Agreement with specific information contained in the report(s) of the Environmental Assessment Firm in accordance with the Supplement provisions of Section 13.21 of this Agreement.

5.24 Cooperation with Respect to Permits, Licenses and Regulatory Matters.

(a) Permits. The Shareholder shall at its sole cost and expense promptly perform such lawful acts and execute and deliver to the Purchaser such documents as the Purchaser may request to obtain the full benefits of the transfer of ownership of the Stock, and the Shareholder shall use commercially reasonable efforts to and shall cooperate with the Purchaser to obtain for the Purchaser all transferable and nontransferable Permits issued by a Governmental Body necessary or appropriate to continue the operation of the Company and the Subsidiaries in the Ordinary Course of Business from and after the Closing Date.

(b) Regulatory Matters. Upon execution of this Agreement, the Purchaser and the Shareholder shall promptly proceed, and the Shareholder shall cause the Company and each Subsidiary to file, all applications, consent requests and associated documentary material required by or necessary to obtain all approvals of any Governmental Body necessary to complete or satisfy the conditions to Closing with respect to the transactions contemplated by this Agreement, including those required by HSR (if applicable), and the North Carolina General Statutes, the VDH and other Applicable Laws. Each party shall bear its own costs with respect to such applications and consent requests.

5.25 Performance and Other Bonds. As of or immediately following the Closing, the Purchaser shall arrange to obtain replacement performance and other bonds which have been posted by the Company, the Subsidiaries and/or the Shareholder (in the coverage amounts and for the term(s) set forth on such bonds) for delivery at the Closing (and to the appropriate Governmental Body, including those required by the NCUC and the VDH) which are set forth in **Schedule 5.25**. All such bonds to be obtained by the Purchaser shall be effective as of the Closing Date for events arising on or after the Closing Date. Evidence satisfactory to the Shareholder of compliance with Applicable Law (including North Carolina General Statute 62-110.3 and NCUC rules R7-37 (water) and R10-24 (wastewater)) with respect to such bonds shall also be provided at the Closing by the Purchaser. The Purchaser acknowledges that (i) it shall have no right or claim to the performance and other bonds presently in existence and which are executed by the Shareholder, and (ii) the Shareholder shall cause the termination and cancellation of each such performance and other bond as of the Closing Date, and the Shareholder shall have the right to any and all proceeds and rebates, if any, therefrom with respect to such termination and cancellation; provided, however, that the cost for such

performance and other bonds was not previously charged to (and paid by) the Company and/or the Subsidiaries by the Shareholder.

5.26 Absence of Certain Developments. Except for the transactions contemplated by this Agreement or as otherwise set forth on **Schedule 5.26** hereto, the Company and the Subsidiaries will conduct the Business only in the Ordinary Course of Business and will not:

(a) Declare, set aside or pay a dividend or make any other distribution with respect to any class of capital stock of the Company or the Subsidiaries;

(b) Change accounting methods or practices (including, without limitation, any change in depreciation, amortization or cost accounting policies or rates);

(c) Except for the transactions contemplated by this Agreement and as otherwise set forth in **Schedule 3.37**, enter into any employment contract or collective bargaining agreement, written or oral, or modify the terms of any existing employment contract or agreement or adopt, amend, modify or terminate any Benefit Plan;

(d) Make any change or amendment in its articles of incorporation or bylaws;

(e) Issue or sell any securities; acquire, directly or indirectly, by redemption or otherwise, any securities; or grant or enter into any options, warrants, calls or commitments of any kind with respect thereto;

(f) Make any capital expenditure exceeding One Hundred Thousand Dollars ($100,000) which are not in the capital expenditure operating budgets of the Company and its Subsidiaries; and/or

(g) Incur any obligations for borrowed money (as opposed to purchase money debt) other than pursuant to the existing credit facilities under the Debt Instruments described and set forth in **Schedule 3.29** of this Agreement; provided, however, the Purchaser (i) acknowledges that the Company is presently in the process of expanding its line of credit with CoBank, ACB from an $8.5 million maximum principal amount available under such line of credit to a maximum principal amount of $11.0 million, and (ii) hereby consents to such expansion of the CoBank, ACB line of credit.

5.27 Certain Accounting Matters.

(a) Unamortized Acquisition Costs. As an affirmative response and accommodation to the Purchaser's request, the Company has agreed to write-off in the November 30, 2003 and December 31, 2003, interim financial statements of the Company and its Subsidiaries certain capitalized preliminary investigation costs arising from development of a wastewater treatment system which would be permitted for discharge in Williamson County, Tennessee. The write-off will approximate $97,000, or $59,000 on an after-tax basis. The Company will also propose this write-off adjustment for the December 31, 2003, audited financial statements by including the write-off in the year-end trial balance prepared for the Company's auditor.

(b) Interim Accrual of Vacation Liability. As a further affirmative response and accommodation to the Purchaser's request, the Company shall present an accrual of vacation pay liability for each interim financial statement of the Company and the Subsidiaries, to be prepared by the Company for delivery to the Purchaser, pursuant to and in accordance with Section 5.18 of this Agreement.

In furtherance of the foregoing, the Shareholder shall cause the Company to, and the Company shall, as of January 1, 2004, accrue in accordance with the Company's vacation pay policy, a full year of vacation pay liability anticipated and calculated by the Company for the calendar year 2004. The amount shall be (i) initially recorded by a debit to "Vacation Pay Deferred Asset" (a balance sheet account) and by a credit to "Vacation Pay Liability" (a balance sheet account), and (ii) amortized on a monthly basis based on actual use of vacation time by all employees by an entry that debits "Vacation Pay Liability" and credits "Vacation Pay Deferred Asset". In the event an employee terminates employment in 2004, the full amount paid to such employee for accrued but unused vacation time shall be recorded as expense in the period incurred as a consequence of the cash payment to the employee, with a corresponding entry (in the same gross amount of the gross vacation pay liability which was remitted to such employee) that debits "Vacation Pay Liability" and credits Vacation Pay Deferred Asset". In the event an employee has carry-over vacation from 2003, the use of that vacation shall be recorded as a debit to "Vacation Pay Liability" and a credit to "Vacation Pay Deferred Asset".

5.28 Capital Expenditures. The Company and its Subsidiaries shall make best reasonable commercial efforts to continue their investment in capital resources in the Ordinary Course of Business consistent with the capital budget(s) established for the Company and the Subsidiaries.

ARTICLE 6
MUTUAL CONDITIONS PRECEDENT TO THE PARTIES' OBLIGATIONS

Unless waived in writing by the parties, each and every obligation of the Purchaser and the Shareholder to be performed at the Closing shall be subject to the satisfaction at or prior thereto of each and all of the following conditions precedent:

6.1 Proceedings. There being no (i) Proceedings which have been brought, asserted or commenced against the Purchaser, the Company, the Subsidiaries and/or the Shareholder by any Person which enjoins or otherwise materially and adversely affects the Purchaser's, the Company's, the Subsidiaries' or the Shareholder's ability to consummate the transactions contemplated hereby or which could reasonably be expected to have a Material Adverse Effect if the transactions contemplated hereby were consummated, (ii) Proceedings that have been Threatened against the Purchaser, the Company, the Subsidiaries and/or the Shareholder by any Person which would enjoin or materially and adversely affect the Purchaser's, the Company's, the Subsidiaries' or the Shareholder's ability to consummate the transactions contemplated hereby or which could reasonably be expected to have a Material Adverse Effect in the event the transactions contemplated hereby were consummated, or (iii) Applicable Laws restraining or enjoining or which may reasonably be expected to nullify or render ineffective this Agreement or

the consummation of the transactions contemplated hereby or which otherwise could reasonably be expected to have a Material Adverse Effect if the transactions contemplated hereby were consummated.

6.2 Consents and Approvals. The Purchaser and the Shareholder shall have received evidence, in form and substance reasonably satisfactory to the respective counsel for the Purchaser and the Shareholder, that all material consents, waivers, releases, authorizations, approvals, licenses, certificates, Permits and franchises of all Persons (including each and every Governmental Body) as may be necessary to lawfully consummate the transactions contemplated by this Agreement and for the Purchaser to carry on and continue the operations of the Company and the Subsidiaries as they are now conducted have been obtained. All consents of a Governmental Body shall be by Final Order; provided, however, that if the Purchaser and the Shareholder waive the condition of Governmental Body consent by Final Order, the parties shall consider the Governmental Body consent without Final Order sufficient to proceed to Closing according to the other terms of this Agreement. All Final Orders shall impose no conditions that could have a Material Adverse Effect on the Company or the Subsidiaries after giving effect to the consummation of this Agreement. "**Final Order**" means an action or decision of the Governmental Body as to which (i) no request for a stay is pending, no stay is in effect, and any deadline for filing such request that may be designated by Applicable Law has passed, (ii) no petition for rehearing or reconsideration or application for review is pending and the time for the filing of such petition or application has passed, (iii) the Governmental Body does not have the action or decision under reconsideration on its own motion and the time within which it may effect such reconsideration has passed, and (iv) no judicial appeal is pending or in effect and any deadline for filing any such appeal that may be designated by statute or rule has passed.

6.3 Antitrust Matters. All waiting periods under HSR have expired, no temporary restraining order, preliminary Injunction or permanent Injunction enjoining the consummation of the transactions contemplated herein has been entered by any court, no action seeking to enjoin the consummation of this transaction has been commenced by any Person, and neither the FTC, the DOJ nor any State Attorney General has Threatened to take any action to enjoin or challenge the transaction contemplated herein. Promptly after the execution of this Agreement, the Purchaser and the Shareholder shall make all filings and submit information requested or required under HSR with the FTC and the DOJ. Neither party hereto shall initiate any substantive discussion with the FTC or DOJ concerning the transactions contemplated by this Agreement without giving the other party reasonable prior notice of such discussion and a reasonable opportunity to participate therein. Each party shall promptly report to the other the fact and general nature of any substantive discussion initiated with it by the FTC or DOJ concerning the transactions contemplated by this Agreement. Notwithstanding the foregoing, the parties hereto have presently determined that filings under HSR are not required due to the amount of the Purchase Price for the Stock.

ARTICLE 7

ADDITIONAL CONDITIONS PRECEDENT TO THE PURCHASER'S OBLIGATIONS

Unless waived by the Purchaser in writing, each and every obligation of the Purchaser to be performed at the Closing shall be subject to the satisfaction at or prior thereto of each and all of the following conditions precedent:

7.1 Accuracy of Representations and Warranties. The representations and warranties (as amended by any Supplement) made by the Shareholder in this Agreement, and the Ancillary Documents to be executed and delivered by the Shareholder pursuant to this Agreement, shall be true and correct in all material respects at and as of the Closing with the same force and effect as though such representations and warranties had been made or given at and as of the Closing.

7.2 Compliance with Covenants and Agreements. The Shareholder, the Company and the Subsidiaries shall have performed and complied with all of their covenants, agreements and obligations under this Agreement and the Ancillary Documents which are to be performed or complied with by them at or prior to the Closing, including the execution and delivery of the Ancillary Documents specified in Section 2.4(b) hereof, all of which shall be reasonably satisfactory in form and substance to the Purchaser.

7.3 No Material Adverse Effect. As of the Closing Date, nothing shall have occurred which would, individually or in the aggregate, have a Material Adverse Effect on the Company and/or the Subsidiaries.

7.4 Legal Opinion. The Purchaser shall have received an opinion from the counsel for the Shareholder, dated as of the Closing Date, in form and substance satisfactory to the Purchaser in the Purchaser's reasonable commercial discretion.

ARTICLE 8

ADDITIONAL CONDITIONS PRECEDENT TO THE SHAREHOLDER'S OBLIGATIONS

Unless waived by the Shareholder in writing, each and every obligation of the Shareholder to be performed at the Closing shall be subject to the satisfaction at or prior thereto of each and all of the following conditions precedent:

8.1 Accuracy of Representations and Warranties. The representations and warranties (as amended by any Supplement) made by the Purchaser in this Agreement and the Ancillary Documents to be executed and delivered by the Purchaser pursuant to this Agreement, shall be true and correct in all material respects at and as of the Closing with the same force and effect as though such representations and warranties had been made or given at and as of the Closing.

8.2 Compliance with Covenants and Agreements. The Purchaser shall have performed and complied with all of its covenants, agreements and obligations under this

Agreement and the Ancillary Agreements which are to be performed or complied with by it at or prior to the Closing, including the execution and delivery of the Ancillary Documents specified in Section 2.4(c) hereof.

8.3 Legal Opinion. The Shareholder shall have received an opinion from the counsel for the Purchaser, dated as of the Closing Date, in form and substance satisfactory to the Shareholder in the Shareholder's reasonable commercial discretion.

8.4 Delivery of Purchase Price and Other Consideration. The Purchaser shall have delivered to the Shareholder, against receipt of the certificates for the Stock, the Purchase Price.

ARTICLE 9

INDEMNIFICATION

9.1 Indemnification by the Shareholder. The Shareholder hereby covenants and agrees to indemnify and hold the Purchaser, its officers, directors, employees, Affiliates, shareholders and agents, and each of their respective successors and assigns, harmless from, against and in respect of any and all losses, costs, expenses (including without limitation, reasonable attorneys' fees and disbursements of counsel), Liabilities, damages, fines, penalties, charges, assessments, judgments, settlements, claims, causes of action and other obligations of any nature whatsoever (excluding, however, Purchaser claims against the Shareholder for incidental, consequential or special damages, including punitive damages, other than those claims which arise from a third party claim against the Company) (individually, a "**Loss**" and collectively "**Losses**") that any of them may at any time, directly or indirectly, suffer, sustain, incur or become subject to, arising out of, based upon or resulting from or on account of each of the following:

(a) the breach or falsity of any representation or warranty made by the Shareholder in this Agreement and the Ancillary Documents to be executed and delivered by the Shareholder pursuant hereto and thereto; provided, however, that the Shareholder shall not be required to provide such indemnification for the breach or falsity of any such representation or warranty (other than representations or warranties contained in Sections 3.1, 3.2, 3.3, 3.4, 3.9, 3.10, 3.23, 3.29, 3.31, 3.33 and 3.35) unless and until the Purchaser, its officers, directors, employees, Affiliates and other representatives shall have sustained cumulative Losses as a result of one or more such breaches or falsities of Five Hundred Thousand Dollars ($500,000) (the "**Basket Amount**"). Once the aggregate of Losses exceeds the Basket Amount, the Shareholder shall provide indemnification for all Losses sustained as a result of such breach(es) or falsity(ies) of the applicable representations and warranties in excess of the Basket Amount; or

(b) the breach of any covenant or agreement made by the Shareholder in this Agreement and the Ancillary Documents to be executed and delivered by the Shareholder or its representatives pursuant hereto or thereto; or

(c) any incurrence by the Purchaser, the Company or the Subsidiaries of an amount or amounts for Transactional Expenses of the Shareholder; or

(d) any claim (i) for Retention Payments, severance pay, bonus, unpaid wages or salaries accruing, incurred or triggered by a termination of employment (voluntary or involuntary) of any employee of the Shareholder, the Company or the Subsidiaries which occurred at any time prior to the Closing or which arises immediately upon and as a consequence of the occurrence of the Closing (but not as a consequence of a hiring and subsequent termination by the Purchaser), or (ii) relating to any claim or Proceeding of any employee of the Shareholder, the Company or the Subsidiaries arising from any act, occurrence, or event, the basis of which is dated at any time prior to, or attributable to, the Closing; or

(e) any and all Losses that arise from, in connection with or incident to any claim, obligation, cost or expense under a guarantee made by the Company or the Subsidiaries on behalf of the Shareholder as described in Section 5.22(a) that are not within the scope of the indemnity from the Purchaser to the Shareholder; or

(f) any and all Losses that arise from, are in connection with, or are incident to any claims set forth in **Schedule 3.24** to the extent such Losses would otherwise be covered under any insurance or self-insurance arrangement.

Notwithstanding the foregoing, any Loss or aggregate Losses to be indemnified by the Shareholder to the Purchaser under this Agreement shall not exceed Seven Million Five Hundred Thousand Dollars ($7.5 Million). Any claim of indemnification by the Purchaser from, in connection with or incident to any Loss or Losses related to Taxes shall be governed by Article 10 of this Agreement.

9.2 Indemnification by the Purchaser. The Purchaser covenants and agrees to defend, indemnify and hold the Shareholder and its respective officers, directors, successors and assigns, harmless from, against and in respect of any and all Losses that it may at any time, directly or indirectly, suffer, sustain, incur or become subject to, arising out of, based upon or resulting from or on account of each or all of the following:

(a) the breach or falsity of any representation or warranty made by the Purchaser in this Agreement and the Ancillary Documents to be executed and delivered by the Purchaser pursuant hereto and thereto; or

(b) the breach of any covenant or agreement made by the Purchaser in this Agreement and the Ancillary Documents to be executed and delivered by the Purchaser pursuant hereto or thereto;

(c) any and all Losses arising from, in connection with or incident to the Shareholder and Affiliate Guarantees described in Section 5.22; or

(d) any and all Losses arising from, in connection with or incident to the Severance Payments.

9.3 Procedure for Indemnification. In the event a party, including its trustees, officers, directors, employees, Affiliates and other representatives, intends to seek indemnification pursuant to the provisions of Sections 9.1 or 9.2 hereof (the "**Indemnified Party**"), the Indemnified Party shall promptly give notice hereunder to the other party (the "**Indemnifying Party**") of a claim or after obtaining written notice of any claim, investigation, or the service of a summons or other initial or continuing legal or administrative process or Proceeding in any action instituted against the Indemnified Party as to which recovery or other action may be sought against the Indemnified Party because of the indemnification provided for in Section 9.1 or 9.2 hereof, and, if such indemnity shall arise from the claim of a third party, the Indemnified Party shall permit the Indemnifying Party to assume the defense of any such claim and any litigation resulting from such claim; provided, however, that the Indemnified Party shall not be required to permit such an assumption of the defense of any claim or Proceeding which, if not first paid, discharged or otherwise complied with, would result in a material interruption or disruption of the business of the Indemnified Party, or any material part thereof. Notwithstanding the foregoing, the right to indemnification hereunder shall not be affected by any failure of the Indemnified Party to give such notice (or by delay by the Indemnified Party in giving such notice) unless, and then only to the extent that, the rights and remedies of the Indemnifying Party shall have been prejudiced as a result of the failure to give, or delay in giving, such notice. Failure by the Indemnifying Party to notify the Indemnified Party of its election to defend any such claim or action by a third party within twenty (20) days after notice thereof shall have been given to the Indemnifying Party shall be deemed a waiver by the Indemnifying Party of its right to defend such claim or action.

If the Indemnifying Party assumes the defense of such claim, investigation or Proceeding resulting therefrom, the obligations of the Indemnifying Party hereunder as to such claim, investigation or Proceeding shall include taking all steps necessary in the defense or settlement of such claim, investigation or Proceeding and holding the Indemnified Party harmless from and against any and all Losses arising from, in connection with or incident to any settlement approved by the Indemnifying Party or any judgment entered in connection with such claim, investigation or Proceeding, except where, and only to the extent that, the Indemnifying Party has been prejudiced by the actions or omissions of the Indemnified Party. The Indemnifying Party shall not, in the defense of such claim or any Proceeding resulting therefrom, consent to entry of any judgment (other than a judgment of dismissal on the merits without costs) except with the written consent of the Indemnified Party (which consent shall not be unreasonably withheld, delayed or conditioned) or enter into any settlement (except with the written consent of the Indemnified Party, which consent shall not be unreasonably withheld, delayed or conditioned) unless (i) there is no finding or admission of any violation of Applicable Law and no material effect on any claims that could reasonably be expected to be made by or against the Indemnified Party, (ii) the sole relief provided is monetary damages that are paid in full for Losses which are or may be properly applied against the Basket Amount, and (iii) the settlement shall include the giving by the claimant or the plaintiff to the Indemnified Party a release from all Liability in respect to such claim or litigation.

If the Indemnifying Party assumes the defense of such claim, investigation or Proceeding resulting therefrom, the Indemnified Party shall be entitled to participate in the defense of the claim, but solely by observation and comment to the Indemnifying Party, and the counsel selected by the Indemnified Party shall not appear on its behalf in any Proceeding arising

hereunder. The Indemnified Party shall bear the fees and expenses of any additional counsel retained by it to participate in its defense unless any of the following shall apply: (i) the employment of such counsel shall have been authorized in writing by the Indemnifying Party, or (ii) the Indemnifying Party's legal counsel shall advise the Indemnifying Party in writing, with a copy to the Indemnified Party, that there is a conflict of interest that would make it inappropriate under applicable standards of professional conduct to have common counsel. If clause (i) or (ii) in the immediately preceding sentence is applicable, then the Indemnified Party may employ separate counsel at the expense of the Indemnifying Party to represent the Indemnified Party, but in no event shall the Indemnifying Party be obligated to pay the costs and expenses of more than one such separate counsel for any one complaint, claim, action or Proceeding in any one jurisdiction.

If the Indemnifying Party does not assume the defense of any such claim by a third party or litigation resulting therefrom after receipt of notice from the Indemnified Party, the Indemnified Party may defend against such claim or litigation in such manner as it reasonably deems appropriate, and unless the Indemnifying Party shall deposit with the Indemnified Party a sum equivalent to the total amount demanded in such claim or litigation plus the Indemnified Party's estimate of the cost (including attorneys' fees) of defending the same, the Indemnified Party may settle such claim or Proceeding on such terms as it may reasonably deem appropriate and the Indemnifying Party shall, subject to its defenses and the applicability of any remaining threshold loss amount provided for in Section 9.1(a) hereof, promptly reimburse the Indemnified Party for the amount of such settlement and for all reasonable costs (including attorneys' fees), expenses and damages incurred by the Indemnified Party in connection with the defense against or settlement of such claim, investigation or litigation, or if any such claim or litigation is not so settled, the Indemnifying Party shall, subject to its defenses and the applicability of any remaining Basket Amount provided for in Section 9.1(a) hereof, promptly reimburse the Indemnified Party for the amount of any final nonappealable judgment rendered with respect to any claim by a third party in such litigation and for all costs (including attorneys' fees), expenses and damage incurred by the Indemnified Party in connection with the defense against such claim or litigation, whether or not resulting from, arising out of, or incurred with respect to, the act of a third party.

Each party shall cooperate in good faith and in all respects with each Indemnifying Party and its representatives (including without limitation its counsel) in the investigation, negotiation, settlement, trial and/or defense of any Proceedings (and any appeal arising therefrom) or any claim. The parties shall cooperate with each other in any notifications to and information requests of any insurers. No individual representative of any Person, or their respective Affiliates shall be personally liable for any Loss or Losses under this Agreement, except as specifically agreed to by said individual representative.

9.4 Dispute Resolution. In the event a dispute arises under this Agreement, except with respect to Section 2.2 or equitable remedies pursued under this Agreement, such disputes shall be resolved in the manner set forth in this Section 9.4.

(a) If a dispute arises under this Agreement, including any question regarding the existence, validity, interpretation or termination hereof, which is not described as an exception in this Section 9.4, the Purchaser and the Shareholder may invoke the dispute

resolution procedure set forth in this Section 9.4 by giving written notice to the other party. The parties shall enter into discussions concerning this dispute. If the dispute is not resolved as a result of such discussion in ten (10) days, an attempt will be made to resolve the matter by a formal nonbinding mediation with an independent neutral mediator agreed to by the parties. If the parties cannot agree on a mediator within a period of ten (10) days after expiration of the ten (10) day period for resolution by discussion, then either party may apply to any court of competent jurisdiction for appointment of a mediator, which appointment shall be binding and nonappealable. Upon commencement of the mediation process, the parties shall promptly communicate with respect to a procedure and schedule for the conduct of the Proceeding and for the exchange of documents and other information related to the dispute. The mediation process shall be deemed ended if the dispute has not been resolved within thirty (30) days after appointment of the mediator.

(b) All claims, disputes or other matters in question between the parties to this Agreement arising out of or relating to this Agreement which are not resolved by mediation in accordance with Section 9.4(a) within thirty (30) days after appointment of a mediator may be resolved pursuant to Section 9.4(c).

(c) The Shareholder and the Purchaser agree and consent that any legal action, suit or Proceeding seeking to enforce this Section 9.4 shall be instituted and adjudicated solely and exclusively in any court of general jurisdiction in North Carolina, or in the United States District Court having jurisdiction in North Carolina and the Shareholder and the Purchaser agree that venue will be proper in such courts and waive any objection which they may have now or hereafter to the venue of any such suit, action or Proceeding in such courts, and irrevocably consent and agree to the jurisdiction of said courts in any such suit, action or Proceeding. The Shareholder and the Purchaser further agree to accept and acknowledge service of any and all process which may be served in any such suit, action or Proceeding in said courts, and also agree that service of process or notice upon them shall be deemed in every respect effective service of process or notice upon them, in any suit, action or Proceeding, if given or made: (i) by a Person over the age of eighteen who personally serves such notice or service of process on the Shareholder or the Purchaser, as the case may be, or (ii) by certified mail, return receipt requested, mailed to the Shareholder or the Purchaser, as the case may be, at their respective addresses set forth in this Agreement.

(d) In the event of a Proceeding filed or instituted between the parties pursuant to this Section 9.4, the prevailing party will be entitled to receive from the adverse party all costs, damages and expenses, including reasonable attorney's fees, incurred by the prevailing party in connection with that action or Proceeding, whether or not the controversy is reduced to judgment or award.

9.5 Effect of Insurance. An Indemnified Party who has a right to make a claim under any policy of insurance with respect to an indemnified claim made by the Indemnified Party shall use commercially reasonable efforts to make such claim on a prompt and competent basis in the manner required by the insurer. The Indemnified Party shall use commercially reasonable efforts to promptly and diligently pursue such claim and shall cooperate fully with the

insurer and the Indemnifying Party in the prosecution of the claim or claims. In the event an Indemnified Party receives insurance proceeds with respect to Losses for which the Indemnified Party has made an indemnification claim prior to the date on which the Indemnifying Party is required pursuant to this Article 9 to pay such indemnification claim, the indemnification claim shall be reduced by an amount equal to such insurance proceeds received by the Indemnified Party less all reasonable out-of-pocket costs incurred by the Indemnified Party in its pursuit of such insurance proceeds. If such insurance proceeds are received by the Indemnified Party after the date on which the Indemnifying Party is required pursuant to this Article 9 to pay such indemnification claim, the Indemnified Party shall, no later than five (5) days after the receipt of such insurance proceeds, reimburse the Indemnifying Party in an amount equal to such insurance proceeds (but in no event in an amount greater than the Losses theretofore paid to the Indemnified Party by the Indemnifying Party) less all reasonable out-of-pocket costs incurred by the Indemnified Party in obtaining such insurance proceeds. In either case, the Indemnifying Party shall compensate the Indemnified Party for all costs incurred by the Indemnified Party subsequent to either the reduction of any indemnification claim as provided above, or the delivery of any such insurance proceeds to the Indemnifying Party as provided above, as the case may be, as a result of any such insurance, including, but not limited to, retrospective premium adjustments, experience-based premium adjustments (whether retroactive or prospective) and indemnification or surety obligations of the Indemnified Party to any insurer. A claim for such costs shall be made by an Indemnified Party by delivery of a written notice to the Indemnifying Party requesting compensation and specifying this Section 9.5 as the basis on which compensation for such costs is sought, and the Indemnifying Party shall pay such costs no later than thirty (30) days after receiving the written notice requesting such compensation. Notwithstanding the foregoing, except to the extent set forth in the first two sentences of this Section 9.5, the Indemnified Party is not required to pursue a recovery from an insurer as a precondition to the Indemnifying Party's obligation to pay any indemnification claim as required by this Article 9, and the Indemnifying Party shall not be entitled to delay any payment beyond the respective payment dates for any indemnification claims referred to in this Article 9 for the purpose of awaiting receipt of insurance proceeds or credits therefor as provided herein.

9.6 Effect of Taxes. The amount of indemnification payment due hereunder shall be reduced by the amount of any Income Tax benefit that the Purchaser, the Company and the Subsidiaries (or their Affiliates) realizes (or will realize) as a result of incurring such Loss. The amount of the Income Tax benefit realized (or that will be realized) as a result of incurring a Loss shall be computed on a hypothetical basis and shall equal the product of (i) the sum of (A) the amount of each Income Tax deduction (or similar benefit) of the Purchaser, the Company and the Subsidiaries (or their Affiliates) resulting from the Loss that is reasonably anticipated to be deductible (or used) in the tax year including the date of indemnification payment (or in any prior tax years) plus (B) the present value as of the date of the indemnification payment of each Income Tax deduction (or similar benefit) of the Purchaser, the Company and the Subsidiaries (or their Affiliates) resulting from the Loss that is reasonably anticipated to be deductible (or used) in any tax year after the tax year of the indemnification payment multiplied by (ii) forty percent (40%). For purposes of clause (B), the present value of a future Income Tax deduction (or similar benefit) shall be determined using a discount rate of five percent (5%) and assuming that all Tax benefits from the deduction (or similar benefit) are realized on the 182nd day of the Company's tax year for the year in which the deduction (or similar benefit) is reasonably anticipated to be claimed.

ARTICLE 10

TAX MATTERS

The following provisions shall govern the allocation of responsibility as between the Purchaser and the Shareholder for certain Tax matters following the Closing Date:

10.1 Tax Returns.

(a) The Shareholder has the exclusive authority and obligation to prepare, execute on behalf of the Company and the Subsidiaries and timely file, or cause to be prepared and timely filed, all Tax Returns of the Company and the Subsidiaries that are due with respect to any taxable year or other taxable period ending prior to or ending on and including the Closing Date. Such authority shall include, but not be limited to, the determination of the manner in which any items of income, gain, deduction, Loss or credit arising out of the income, properties and operations of the Company and the Subsidiaries shall be reported or disclosed in such Tax Returns; provided, however, that such Tax Returns shall be prepared by treating items on such Tax Returns in a manner consistent with the past practices with respect to such items and in a manner consistent with all applicable IRS regulations.

(b) Except as provided in Section 10.1(a), the Purchaser shall have the exclusive authority and obligation to prepare, execute on behalf of the Company and the Subsidiaries and timely file, or cause to be prepared and timely filed, all Tax Returns of the Company and the Subsidiaries that are due with respect to any taxable year or other taxable period ending after the Closing Date; provided, however, with respect to Tax Returns to be filed by the Purchaser pursuant to this Section 10.1 for taxable periods beginning before the Closing Date and ending after the Closing Date, items set forth on such Tax Returns shall be treated in a manner consistent with the past practices with respect to such items. Such authority shall include, but not be limited to, the determination of the manner in which any items of income, gain, deduction, Loss or credit arising out of the income, properties and operations of the Company shall be reported or disclosed on such Tax Returns.

10.2 Controversies. The Purchaser shall promptly notify the Shareholder in writing upon receipt by the Purchaser or any Affiliate of the Purchaser (including the Company and the Subsidiaries after the Closing Date) of written notice of any inquiries, claims, assessments, audits or similar events with respect to Taxes relating to a taxable period ending prior to or ending on and including the Closing Date for which the Shareholder may be liable under this Agreement (any such inquiry, claim, assessment, audit or similar event, a "**Tax Matter**"). The Shareholder, or its duly appointed representative (the "**Shareholder's Representative**"), at its sole expense, shall have the authority to represent the interests of the Company and the Subsidiaries with respect to any Tax Matter before the IRS, any other taxing authority, any other governmental agency or authority or any court and shall have the sole right to control the defense, compromise or other resolution of any Tax Matter, including responding to inquiries, filing Tax Returns and contesting, defending against and resolving any assessment for additional Taxes or notice of Tax deficiency or other adjustment of Taxes of, or relating to, a Tax Matter; provided, however, that

neither the Purchaser nor any of its Affiliates shall enter into any settlement of or otherwise compromise any Tax Matter that affects or may affect the Tax Liability of the Shareholder, the Company, the Subsidiaries or any Affiliate of the foregoing for any period ending after the Closing Date, which includes a portion of a period beginning before the Closing Date and ending after the Closing Date (the "**Overlap Period**"), without the prior written consent of the Shareholder or the Shareholder's Representative, which consent shall not be unreasonably withheld, delayed or conditioned. The parties hereto shall keep the other fully and timely informed with respect to the commencement, status and nature of any Tax Matter.

Except as otherwise provided in this Section 10.2, the Purchaser shall have the sole right to control any audit or examination by any taxing authority, initiate any claim for refund or amend any Tax Return, and contest, resolve and defend against any assessment for additional Taxes, notice of Tax deficiency or other adjustment of Taxes of, or relating to, the income, assets or operations of the Company and the Subsidiaries for all taxable periods; provided, however, that the Purchaser shall not, and shall cause its Affiliates (including the Company and the Subsidiaries) not to, enter into any settlement of any contest or otherwise compromise any issue with respect to the portion of the Overlap Period ending on or prior to the Closing Date without the prior written consent of the Shareholder, which consent shall not be unreasonably withheld, delayed or conditioned.

10.3 Transfer Taxes. All transfer, documentary, stamp, registration, sales and use and similar Taxes and fees (including all penalties and interest) imposed in connection with the sale of the Stock or any other transaction that occurs pursuant to this Agreement shall be the obligation of the Shareholder.

10.4 Amended Tax Returns. The Shareholder, the Company and the Subsidiaries shall not file or cause to be filed any amended Tax Return or claims for refund without the prior written consent of the Purchaser, which consent shall not be unreasonably withheld, delayed or conditioned, except for such amended Tax Returns or claims for refund filed in connection with the resolution of any Tax Matter in accordance with Section 10.2.

10.5 Non-foreign Person Affidavit. The Shareholder shall furnish to the Purchaser on or before the Closing Date a non-foreign Person affidavit as required by Section 1445 of the Code.

10.6 Tax Indemnification.

(a) Tax Indemnification. The Shareholder hereby covenants and agrees to indemnify, defend and hold harmless the Purchaser, its Affiliates (including the Company and the Subsidiaries) and the successors to the foregoing (and their respective shareholders, officers, directors, employees and agents) against (i) all Losses with respect to any claims that may be asserted by any party based upon the breach of any representation or warranty made with respect to Taxes in this Agreement, including those made pursuant to Section 3.9, (ii) all Taxes imposed on or asserted against the properties, income or operations of the Company or the Subsidiaries for all Pre-Closing Periods to the extent such Taxes have not been fully reserved for in the financial statements of the Company as of the last day of the month preceding the Closing Date, and (iii) all Taxes

imposed on the Company or the Subsidiaries, or for which the Company or the Subsidiaries may be liable, as a result of any transaction contemplated by this Agreement. The Purchaser shall promptly give the Shareholder or its respective representatives written notice of all Taxes, Losses, claims and expenses which the Purchaser has reasonably determined may give rise to a right of indemnification under this Section 10.6(a), including a computation of the amount of the claimed indemnification with sufficient detail and particularity to enable the Shareholder to reasonably determine the amount of such required indemnification.

(b) Notification of Claims. In the event that the Purchaser fails to notify the Shareholder with respect to a Tax Matter in accordance with the provisions of Section 10.2, the Shareholder shall not be obligated to indemnify the Purchaser under this Section 10.6 to the extent that such failure to notify the Shareholder has a Material Adverse Effect on the Shareholder's ability to defend against such Tax Matter.

10.7 Section 338 Election. The Shareholder and the Purchaser have agreed that an election under Section 338(h)(10) of the Code, and any comparable state or local Tax provision, shall be made by the Purchaser and the Shareholder with respect to the Purchaser's acquisition of the Stock of the Company and each Subsidiary. In this regard, the Purchaser shall prepare, and the Shareholder shall assist in the preparation of, Forms 8883 or comparable state or local Tax forms in a manner consistent with the allocation of the Purchase Price to assets reflected in **Schedule 10.7**. Upon presentation of any such Form 8883 or comparable state or local Tax form by the Purchaser, the Shareholder shall promptly execute and return such forms to the Purchaser for inclusion with the Purchaser's Tax Return and, if necessary, the Shareholder shall include a copy of such form with its own Tax Return for the Tax period that includes the purchase of the Stock.

10.8 Post-Closing Access and Cooperation. From and after the Closing Date, the Purchaser agrees, and agrees to cause the Company and the Subsidiaries, to permit the Shareholder and its representatives to have reasonable access, during normal business hours, to the books and records of the Company and the Subsidiaries, to the extent that such books and records relate to a Pre-Closing Period, and personnel, for the purpose of enabling the Shareholder to: (i) prepare Tax Returns, (ii) investigate or contest any Tax Matter which the Shareholder has the authority to conduct, and (iii) evaluate any claim for indemnification.

ARTICLE 11

PERFORMANCE FOLLOWING THE CLOSING DATE

The following covenants and agreements are to be performed after the Closing by the parties and shall continue in effect for the periods respectively indicated or, where no indication is made, until performed:

11.1 Further Acts and Assurances. The parties agree that, at any time and from time to time, on and after the Closing Date, upon the reasonable request of the other party, they will do or cause to be done all such further acts and things and execute, acknowledge and deliver, or cause to be executed, acknowledged and delivered any and all papers, documents, instruments,

agreements, assignments, transfers, assurances and conveyances as may be necessary or desirable to carry out and give effect to the provisions and intent of this Agreement. In addition, from and after the Closing Date, the Purchaser will afford to the Shareholder and its attorneys, accountants and other representatives access, during normal business hours, to such personnel, books and records relating to the Company and/or the Subsidiaries as may reasonably be required in connection with the preparation of financial information or the filing of Tax Returns and will cooperate in all reasonable respects in connection with claims and Proceeding asserted by or against third parties, relating to or arising from the transactions contemplated hereby.

11.2 Non-Competition Agreement. During the period of thirty-six (36) months from and after the Closing Date, the Shareholder, on behalf of itself and its Affiliates (other than the Company and the Subsidiaries), covenants and agrees that it will not, without the Purchaser's prior written consent, which may be withheld or given in its sole discretion, directly or indirectly, or individually or collectively within the State of North Carolina, lend any material credit, advice or assistance, or engage in any activity or act in any manner, including but not limited to, as a founder, promoter, partner, joint venturer, shareholder other than as a less than five percent (5%) shareholder of a publicly traded corporation, officer, director, trustee, manager, licensor, licensee, principal, agent, broker, representative, consultant, advisor, investor or otherwise for the purpose of establishing, operating or managing any business or entity that is engaged in activities competitive with the Business of the Company or the Subsidiaries.

11.3 Non-Solicitation Agreement. During the period of thirty-six (36) months from and after the Closing Date, the Shareholder covenants and agrees that it will not, whether for its own account or for the account of any other Person, directly or indirectly interfere with the relationship of the Company or the Subsidiaries with, or endeavor to divert or entice away from, the Company or the Subsidiaries any Person who or which at any time during the term of the Shareholder's affiliation with the Company or the Subsidiaries is an employee, vendor, supplier or customer of the Company or the Subsidiaries. The foregoing shall not apply to employees, vendors, suppliers or customers who do not, at the time of any solicitation, have a relationship with the Company or a Subsidiary in such capacity.

11.4 Reasonableness of Covenants. The Shareholder, on behalf of itself, its trustees, shareholders and Affiliates, acknowledges and agrees that the geographic scope and period of duration of the restrictive covenants contained in Sections 11.2 and 11.3 of this Agreement are both fair and reasonable and that the interests sought to be protected by the Purchaser, the Company and the Subsidiaries are legitimate business interests entitled to be protected. The Shareholder further acknowledges and agrees that the Purchaser would not have purchased the Shareholder's Stock in the Company pursuant to this Agreement unless the Shareholder agreed to the covenants contained in such Sections.

11.5 Injunctive Relief. The parties agree that the remedy of damages at law for the breach by any party of any of the covenants contained in Sections 11.2 and 11.3 is an inadequate remedy. In recognition of the irreparable harm that a violation by the Shareholder, its officers, directors, shareholders or Affiliates, of any of the covenants, agreements or obligations arising under Sections 11.2 and 11.3 would cause the Purchaser and the Company, the Shareholder, on behalf of itself, its officers, directors, shareholders and Affiliates, agrees that in addition to any other remedies or relief afforded by law, an Injunction against an actual or threatened violation

or violations may be issued against it and/or them and every other Person concerned thereby, it being the understanding of the parties that both damages and Injunction shall be proper modes of relief and are not to be considered alternative remedies.

11.6 Blue Pencil Doctrine. In the event that any of the restrictive covenants contained in this Article shall be found by a court of competent jurisdiction to be unreasonable by reason of its extending for too great a period of time or over too great a geographic area or by reason of its being too extensive in any other respect, then such restrictive covenant shall be deemed modified to the minimum extent necessary to make it reasonable and enforceable under the circumstances.

11.7 Guarantees. In furtherance of the provisions of Section 5.22 hereof, the Shareholder shall (i) have a continuing obligation after the Closing to terminate, extinguish or otherwise remove any and all of the guarantees described in Section 5.22 hereof, and (ii) defend and indemnify the Purchaser with respect to such guarantees in accordance with Article 9 of this Agreement, including Section 9.1.

11.8 Employee Matters.

(a) Employment. Each Employee who is employed by the Company or either Subsidiary on the Closing Date shall continue to be employed by the Company or the Subsidiary, as applicable, on and after the Closing Date at substantially the same base wage or salary as in effect immediately prior to the Closing Date. Such continued employment shall be employment at-will, and nothing in this Section 11.8 is intended to create, or shall create or confer, any right of employment after the Closing Date for any Employee.

(b) Benefit Plans. Prior to the Closing Date, the Company shall have (i) with respect to the Benefit Plans sponsored by the Company as set forth in **Schedule 3.10(a)(1), (2), (3), (4) and (11) through (23)** (the "**Company Plans**"), terminated the participation in any such Company Plan of any individual who is not an employee of the Company, (ii) with respect to the Company Plan set forth in **Schedule 3.10(a)(4)**, timely amended such Company Plan to lower the health care spending account maximum annual election for the 2004 plan year to $3,600, and (iii) with respect to the Company Plan set forth in **Schedule 3.10(a)(13)**, prepared and made any necessary 5500 filings and, to the extent necessary, entered into the Department of Labor Delinquent Filers Voluntary Compliance Program to assure plan compliance. The Purchaser shall, in its sole discretion, decide (i) whether benefits for the Employees shall be provided under benefit plans designated by the Purchaser which are maintained by the Purchaser and its Affiliates for their employees (each a "**Purchaser Plan**") or (ii) whether such benefits shall continue to be provided under one or more of the Company Plans. The Shareholder shall cause the Company and the Subsidiaries to cooperate with the Purchaser, and the Purchaser shall cooperate with the Company and the Subsidiaries, in making arrangements to terminate on the Closing Date those Company Plans designated by the Purchaser and any contracts with respect to the provision of benefits under such Company Plans, in accordance with the terms of such Company Plans and contracts. Notwithstanding the foregoing, in the event that arrangements cannot be made to ensure that termination of a Company Plan (which is to be replaced in whole or in part by a

corresponding Purchaser Plan) cannot occur without a period of non-coverage or interruption in coverage, then arrangements for the termination of such Company Plan shall not occur until it is ensured that there will be no period of non-coverage or interruption of coverage in the transition from the applicable Company Plan to the corresponding Purchaser Plan. The Purchaser shall waive any waiting periods for coverage under a Purchaser Plan which replaces a Company Plan for Employees covered under such replaced Company Plan. The Purchaser shall credit the Employees with any amounts credited under the Company's medical plan toward an out-of-pocket maximum with respect to satisfaction of an out-of-pocket maximum under Purchaser's medical plan. The Purchaser shall also cause the Company and the Subsidiaries to continue to recognize and honor each Employee's accrued but unused vacation days as of the Closing Date and in the event of an Employee's termination of employment, to provide for payment of any such accrued vacation days which remain unused and to which the Employee remains entitled upon termination of employment.

(c) Rollover of Accounts. With respect to the Benefit Plan set forth in **Schedule 3.10(a)(5)** (i) the Company shall, and/or shall cause its Affiliate: (A) to submit to the IRS, prior to the end of the remedial amendment period, an application for a determination letter with respect to such Benefit Plan as adopted effective January 1, 1997 and as amended thereafter and (B) to take such action, prior to the Closing Date, as may be necessary or appropriate to terminate the Company's and the Subsidiaries' participation in such Benefit Plan, and (ii) the Purchaser shall take such action, prior to the Closing Date, as may be necessary or appropriate to enable the Employees, effective immediately following the Closing Date, to rollover account balances and outstanding plan loans under such Benefit Plan, to a comparable pension benefit plan sponsored by the Purchaser.

(d) Discontinue Participation in Third Party Plans. Prior to the Closing Date, the Company and the Subsidiaries shall, and shall cause their Affiliates, to take such action as may be necessary or appropriate to discontinue the Company's and the Subsidiaries' participation in the Benefit Plans sponsored by the Shareholder or Florida Water Services Corporation as set forth in **Schedule 3.10(a)(6), (7), (8), (9) and (10)** (collectively the "**Third Party Plans**"). The parties understand and agree that (i) the Company and/or its Affiliates may amend such Third Party Plans prior to the Closing Date as may be necessary or appropriate, in the discretion of the Company and/or its Affiliates, to discontinue the Company's participation in such Third Party Plans or for other reasons, (ii) the Purchaser is not assuming any of such Third Party Plans nor the liabilities associated therewith, and (iii) the Shareholder shall assume all liabilities under such Third Party Plans with respect to Employees or former employees of the Company and the Subsidiaries and shall indemnify and hold the Purchaser, the Company and the Subsidiaries and their officers, directors, employees, Affiliates, shareholders and agents and each of their respective successors and assigns, harmless from, against and in respect of all such liabilities and any costs or expenses (including without limitation, reasonable attorneys' fees) and any and all other Losses with respect to such Third Party Plans.

(e) Service Credit. All past service of the Employees with the Company and/or the Subsidiaries shall be taken into account for purposes of eligibility and vesting

under the benefit plans provided by the Purchaser and for purposes of calculating vacation benefits and severance benefits under the vacation plan and severance plan maintained by the Purchaser. Nothing in this Section 11.8(e) shall abrogate or otherwise affect any Employee's right under the Employee severance provisions set forth in the Retention and Severance Agreements.

(f) Employee Severance. The Purchaser acknowledges and agrees that the Company and each of the Subsidiaries have entered into legal, binding and enforceable Retention and Severance Agreements with each of the Employees as set forth in **Exhibit D** to this Agreement. The "**Severance Payment**" (as defined in **Exhibit D**) is calculated in accordance with the Employee's employment position, term of service and is capped at a specified level, as set forth in **Schedule 11.8**. The Company or the applicable Subsidiary shall be responsible for funding and payment of any and all Severance Payments, without recourse to the Shareholder.

11.9 Indemnification of Officers and Directors of the Company and the Subsidiaries.

(a) Indemnification. After the Closing, the Company will, and the Purchaser will cause the Company and each of the Subsidiaries to: (i) indemnify, defend and hold harmless the present and former officers, directors, employees, representatives and agents of the Company and each of the Subsidiaries (collectively, the "**Director Indemnified Parties**" and individually, a "**Director Indemnified Party**") in respect of acts or omissions occurring on or prior to the Closing Date to the extent provided under Applicable Law or under the organizational documents of the Company or the Subsidiaries, in each case as in effect on the date hereof, and (ii) advance expenses as incurred by such officers, directors, employees, representatives and agents of the Company and/or the Subsidiaries to the fullest extent permitted under Applicable Law or under the organizational documents of the Company and/or the Subsidiaries, whichever is greater, in each case as in effect on the date hereof; provided, that such indemnification and advancement of expenses shall be subject to any limitation imposed from time to time under Applicable Law.

(b) No Claims. Except as set forth in **Schedule 11.9**, there are no pending, nor, to the Knowledge of the Company, Threatened, claims as described in Section 11.9(a) for indemnification by any Director Indemnified Party.

(c) Insurance Proceeds. If the Company and/or the Subsidiaries provide indemnification and/or advancement of expenses as provided for in Section 11.9(a) above, the Company and/or the Subsidiaries shall be entitled to all of the proceeds of any insurance providing coverage under any policies maintained by the Parent, the Shareholder, the Company, the Subsidiaries, or any of their Affiliates for such acts or omissions prior to the Closing Date.

(d) Third Party Beneficiaries. Notwithstanding any contrary provision set forth in this Agreement or any Ancillary Document, the provisions of this Section 11.9

are intended for the benefit of, and shall be directly enforceable by, each of the Director Indemnified Parties, their heirs and personal representatives.

ARTICLE 12

TERMINATION

12.1 Termination. This Agreement may be terminated and the transactions contemplated herein may be abandoned after the date of this Agreement, but not later than the Closing:

(a) by mutual written consent of all parties hereto;

(b) by the Purchaser or the Shareholder if (i) any of the conditions provided for in Article 6 of this Agreement have not been met and have not been waived in writing by the party seeking to terminate on or before the Closing Date, and (ii) any party seeking to terminate this Agreement was not the cause of the failure of the condition to be satisfied;

(c) by the Purchaser if (i) any of the conditions provided for in Article 7 of this Agreement have not been met and have not been waived in writing by the Purchaser on or before the Closing Date, and (ii) the Purchaser was not the cause of the failure of the condition to be satisfied;

(d) by the Shareholder if (i) any of the conditions provided for in Article 8 of this Agreement have not been met and have not been waived in writing by the Shareholder on or before the Closing Date, and (ii) the Shareholder was not the cause of the failure of the condition to be satisfied;

(e) by either the Purchaser or the Shareholder if the Closing shall not have occurred on or before September 30, 2004; and

(f) by a party who objects to a Supplement and meets the criteria for the exercise of a termination right under and pursuant to Section 13.21.

In the event of termination or abandonment by any party as provided in this Section 12.1, written notice shall forthwith be given to the other party and, except as otherwise provided herein, each party shall pay its own expenses incident to preparation or consummation of this Agreement and the transactions contemplated hereunder and neither party shall have any Liability to the other hereunder except such Liability as may arise as a result of a breach hereof.

12.2 Return of Documents and Nondisclosure. If this Agreement is terminated for any reason pursuant to Section 12.1 hereto, each party and its counsel shall return all documents and materials which shall have been furnished by or on behalf of the other party, and all copies thereof, and each party hereby covenants that it will not Use or Disclose to any Person any Confidential Information about the other party or any information about the transactions contemplated hereby, except insofar as may be necessary to comply with the requirements of any Governmental Body or Order or to assert its rights hereunder.

ARTICLE 13

MISCELLANEOUS

13.1 Survival of Representations and Warranties, Covenants and Agreements. Each of the (i) representations and warranties of the parties contained in this Agreement and in any Ancillary Documents delivered by or on behalf of any of the parties hereto pursuant to this Agreement and the transactions contemplated hereby, and (ii) indemnification covenants set forth in Sections 9.1 and 9.2 hereof, shall survive the Closing of the transactions contemplated hereby and any investigation made by the parties or their agents for a period of eighteen (18) months after the Closing, after which no claim for indemnification for any breach of any representation or warranty under this Agreement or covenants to indemnify under Sections 9.1 and 9.2 hereof (i) may be brought, (ii) no action with respect thereto may be commenced, and (iii) no party shall have any Liability or obligation with respect thereto, unless (i) the Indemnified Party gave written notice to the Indemnifying Party specifying with particularity the breach of representation or warranty or indemnification covenants set forth in either of Sections 9.1 or 9.2 claimed on or before the expiration of such eighteen (18) month period, (ii) the claim relates to a breach of any representations or warranties contained in Sections 3.9, 3.10, 3.11 or 3.25, in which case the right to indemnification shall survive until the expiration of the applicable statute of limitations, or (iii) the claim relates to any representation or warranty in Sections 3.2 or 3.35, in which case the representation or warranty shall indefinitely survive the Closing. The covenants and agreements arising from, incident to or in connection with this Agreement, other than the indemnification covenants set forth in Section 9.1 and 9.2 hereof shall survive the Closing indefinitely, until such covenants and agreements are fully satisfied and require no performance or forbearance, or the rights of a party hereto expire on a specific date by the terms hereof.

13.2 Preservation of and Access to Records. The Purchaser shall preserve or cause the Company and the Subsidiaries to preserve all books and records of the Company and the Subsidiaries for a period of six (6) years after the Closing Date, or any later date of retention required by Applicable Law; provided, however, the Purchaser may destroy any part or parts of such records upon obtaining written consent of the Shareholder for such destruction, which consent may be withheld in the Shareholder's absolute discretion. Such records shall be made available to the Shareholder and its representatives at all reasonable times during normal business hours of the Company and/or the Subsidiaries, as applicable, during said six-year period with the right at the Shareholder's expense to make abstracts from and copies thereof.

13.3 Cooperation. The parties hereto shall cooperate with each other in all respects, including using commercially reasonable efforts to assist each other in satisfying the conditions precedent to their respective obligations under this Agreement, to the end that the transactions contemplated hereby will be consummated.

13.4 Public Announcements. The timing and content of all public announcements relating to the execution of this Agreement and the consummation of the transactions contemplated hereby shall be approved by both the Purchaser and the Shareholder prior to the release of such public announcements, and each party agrees to cooperate with the other party as appropriate to comply with all Applicable Laws.

13.5 Notices. All notices, demands and other communications provided for hereunder shall be in writing and shall be given (i) by personal delivery, (ii) via facsimile transmission (receipt telephonically confirmed), (iii) by nationally recognized overnight courier (prepaid), or (iv) by certified or registered first class mail, postage prepaid, return receipt requested, sent to each party, at its and its representative's address as set forth below or at such other address or in such other manner as may be designated by such party or the respective representative in a written notice to each of the other parties. All such notices, demands and communications shall be effective (i) when personally delivered, (ii) one (1) business day after delivery to the overnight courier, (iii) upon telephone confirmation of facsimile transmission, or (iv) upon receipt after dispatch by mail to the party to whom the same is so given or made:

If to the Purchaser: Philadelphia Suburban Corporation
762 West Lancaster Avenue
Bryn Mawr, PA 19010
Fax No.: (610) 645-1061
Attention: Chairman, President and Chief Executive Officer

With a copy to: Piper Rudnick LLP
3400 Two Logan Square
18th and Arch Streets
Philadelphia, PA 19103
Fax No.: (215) 606-3341
Attention: Peter J. Tucci

If to the Shareholder: ALLETE Water Services, Inc.
30 West Superior Street
Duluth, MN 55802-2093
Fax No.: (218) 723-3960
Attention: General Counsel

With a copy to: Briggs and Morgan, Professional Association
2400 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
Fax No.: (612) 334-8650
Attention: Michael J. Grimes

13.6 Entire Agreement. Except for any confidentiality agreement executed by a party hereto (which shall, by the terms hereof, expire upon the Closing), this Agreement, including the Ancillary Documents to be executed by the parties pursuant hereto, contains the entire agreement of the parties hereto and supersedes all prior or contemporaneous agreements and understandings, oral or written, between the parties hereto with respect to the subject matter hereof.

13.7 Remedies. The respective indemnification obligations of the parties set forth in Article 9 of this Agreement are the exclusive remedies of the parties and their successors, assigns or others seeking to claim by, through, or on behalf of a party, under this Agreement, and no

other remedy or remedies, whether arising under any Applicable Law, common law or otherwise, may be used, asserted or prosecuted in connection with this Agreement and any transaction, occurrence, or omission arising from, in connection with or otherwise based upon this Agreement; provided, however, that all equitable remedies shall remain available other than rescission, which shall not be an available remedy of either party hereto, or their respective successors and assigns, under or pursuant to this Agreement. This Section 13.7 shall not be applicable in the specific instances in which a party hereto has committed fraud.

13.8 Amendments. No purported amendment, modification or waiver of any provision of this Agreement or any of the documents, instruments or agreements to be executed by the parties pursuant hereto shall be effective unless in a writing specifically referring to this Agreement and signed by all of the parties hereto.

13.9 Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, personal representatives, successors and permitted assigns, but except as hereinafter provided in this Section, nothing in this Agreement is to be construed as an authorization or right of any party to assign its rights or delegate its duties under this Agreement without the prior written consent of the other parties hereto. In its sole discretion the Purchaser may assign its rights in and/or delegate its duties under this Agreement to an Affiliate of the Purchaser. In the event of such an assignment of rights and/or delegation of duties, all references to the Purchaser or the Shareholder, as applicable to the assignment in this Agreement shall also be deemed to be references to the Person to which this Agreement is assigned; provided that no such assignment and/or delegation shall relieve the assignor of any of its duties or obligations hereunder.

13.10 Fees and Expenses. Each party hereto shall pay their own fees and expenses incurred in connection with negotiating and preparing this Agreement and consummating the transactions contemplated hereby, including but not limited to fees and disbursements of their respective attorneys, accountants and investment bankers. If the transaction is consummated, all fees and expenses, including legal, accounting, investment banking, broker's and finder's fees and expenses incurred by the Shareholder in connection with this transaction (the "**Transactional Expenses**") shall be deemed expenses of the Shareholder and shall be borne by the Shareholder.

13.11 Governing Law and Jurisdiction. This Agreement, including the Ancillary Documents to be executed and/or delivered by the parties pursuant hereto, shall be construed, governed by and enforced in accordance with the internal laws of the State of North Carolina, without giving effect to the principles of comity or conflicts of laws thereof. The Shareholder and the Purchaser agree and consent that any legal action, suit or Proceeding seeking to enforce any provision of this Agreement with the exception of Section 9.4 (which is governed by Section 9.4(c)) shall be instituted and adjudicated solely and exclusively in any court of general jurisdiction in North Carolina, or in the United States District Court having jurisdiction in North Carolina and the Shareholder and the Purchaser agree that venue will be proper in such courts and waive any objection which they may have now or hereafter to the venue of any such suit, action or Proceeding in such courts, and each hereby irrevocably consents and agrees to the jurisdiction of said courts in any such suit, action or Proceeding. The Shareholder and the Purchaser further agree to accept and acknowledge service of any and all process which may be

served in any such suit, action or Proceeding in said courts, and also agree that service of process or notice upon them shall be deemed in every respect effective service of process or notice upon them, in any suit, action, Proceeding, if given or made (i) according to Applicable Law, (ii) by a Person over the age of 18 who personally served such notice or service of process on the Shareholder or the Purchaser, as the case may be, or (iii) by certified mail, return receipt requested, mailed to the Shareholder or the Purchaser, as the case may be, at their respective addresses set forth in this Agreement.

13.12 Counterparts and Facsimile Signature. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same Agreement. The counterparts of this Agreement and all Ancillary Documents may be executed and delivered by facsimile signature by any of the parties to any other party and the receiving party may rely on the receipt of such document so executed and delivered by facsimile as if the original had been received.

13.13 Headings. The headings of the articles, sections and subsections of this Agreement are intended for the convenience of the parties only and shall in no way be held to explain, modify, construe, limit, amplify or aid in the interpretation of the provisions hereof. The terms "this Agreement," "hereof," "herein," "hereunder," "hereto" and similar expressions refer to this Agreement as a whole and not to any particular article, section, subsection or other portion hereof and include the Schedules and Exhibits hereto and any document, instrument or agreement executed and/or delivered by the parties pursuant hereto.

13.14 Scope of Agreement. Unless the context otherwise requires, all references in this Agreement or in any Schedule or Exhibit hereto, to the assets, properties, operations, business, financial statements, employees, books and records, accounts receivable, accounts payable, Contracts or other attributes of the Business shall mean such items or attributes as they are used in, apply to, or relate to the Business.

13.15 Number and Gender. Unless the context otherwise requires, words importing the singular number shall include the plural and vice versa and words importing the use of any gender shall include all genders.

13.16 Severability. In the event that any provision of this Agreement is declared or held by any court of competent jurisdiction to be invalid or unenforceable, such provision shall be severable from, and such invalidity or unenforceability shall not be construed to have any effect on, the remaining provisions of this Agreement, unless such invalid or unenforceable provision goes to the essence of this Agreement, in which case the entire Agreement may be declared invalid and not binding upon any of the parties.

13.17 Parties in Interest. Except for the third party beneficiaries specifically identified as a class in Section 11.9 hereof, nothing implied in this Agreement is intended or shall be construed to confer any rights or remedies under or by reason of this Agreement upon any Person other than the Purchaser and the Shareholder and their respective representatives, successors and permitted assigns. Nothing in this Agreement is intended to relieve or discharge the Liabilities of any third Person to the Purchaser or the Shareholder.

13.18 Waiver. The terms, conditions, warranties, representations and indemnities contained in this Agreement, including the documents, instruments and agreements executed and delivered by the parties pursuant hereto, may be waived only by a written instrument executed by the party waiving compliance. Any such waiver shall only be effective in the specific instance and for the specific purpose for which it was given and shall not be deemed a waiver of any other provision hereof or of the same breach or default upon any recurrence thereof. No failure on the part of a party hereto to exercise and no delay in exercising any right hereunder shall operate as a waiver thereof nor shall any single or partial exercise of any right hereunder preclude any other or further exercise thereof or the exercise of any other right.

13.19 Construction. The parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement. The words "including," "include" or "includes" shall mean including without limitation. The parties intend that each representation, warranty and covenant contained herein shall have independent significance. If any party has breached any representation, warranty or covenant contained herein in any respect, the fact that there exists another representation, warranty or covenant relating to the same subject matter (regardless of the relative levels of specificity) which the party has not breached shall not detract from or mitigate the fact that the party is in breach of the first representation, warranty or covenant.

13.20 Specific Performance. The parties hereto agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to injunctive relief to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof in any court of the United States or any state having jurisdiction, this being in addition to any other remedy to which they are entitled at law or in equity.

13.21 Supplementation of Schedules. The Shareholder or the Purchaser may elect to deliver a supplement ("**Supplement**") to one or more of the Schedules previously delivered to the other in accordance with the procedures set forth in this Section 13.21 as follows:

(a) Prior to the Closing Date, any and all Supplements must be in writing and must be delivered to the other party as soon as practicable, but in no event later than the date that is five (5) business days prior to the scheduled Closing Date. The other party shall be given the opportunity during the five (5) business days following the delivery of the proposed Supplement to consider that Supplement. If the recipient does not object to the contents of the Supplement within such period, the Schedule in question shall be deemed amended as of the date of this Agreement by the Supplement. If the recipient objects to a proposed Supplement, the sole remedy of such objecting party shall be termination of this Agreement in accordance Section 12.1(f) of this Agreement, provided, however, such termination right shall only be available if the matter(s) disclosed in the Supplement could reasonably be determined to have a Material Adverse Effect (and, if the foregoing prevents a termination due to the determination that the matter(s) disclosed in the Supplement could not reasonably be determined to have a Material Adverse Effect,

the Schedule in question shall be deemed amended, as described above); and provided, further, the right to provide the Supplement shall only be available if (i) the Supplement was prepared in connection with or was made necessary by a change in circumstance of which the party proposing the Supplement was unaware from the date of this Agreement to the date of the proposed Supplement, or (ii) the omission from the original Schedule(s) was ministerial in nature and the Supplement is not material to the Company and the Subsidiaries taken as a whole; and

(b) Any and all Supplements delivered within five (5) business days prior to the scheduled Closing Date must be in writing and delivered to the other party pursuant to Section 13.5 of this Agreement, and will only be deemed to amend a Schedule with the written consent of the recipient of the Supplement.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by duly authorized representatives as of the day, month and year first above written.

SHAREHOLDER:

ALLETE WATER SERVICES, INC.

By /s/ James K. Vizanko
James K. Vizanko
President and Chief Financial Officer

PURCHASER:

PHILADELPHIA SUBURBAN CORPORATION

By /s/ Nicholas DeBenedictis
Nicholas DeBenedictis
Its Chairman, President and Chief Executive Officer

[SIGNATURE PAGE TO STOCK PURCHASE AGREEMENT]

WHOLESALE POWER COORDINATION AND DISPATCH OPERATING AGREEMENT

Between

MINNESOTA POWER, INC.

and

SPLIT ROCK ENERGY LLC

This WHOLESALE POWER COORDINATION AND DISPATCH OPERATING AGREEMENT ("AGREEMENT") dated the 14th day of April, 2000, as amended as of January 30, 2004, between Minnesota Power, Inc, a Minnesota corporation ("MP"), and SPLIT ROCK ENERGY LLC, a Minnesota limited liability company ("Split Rock"). For purposes of this AGREEMENT, MP or Split Rock shall be referred to individually as a "Party" and collectively as the "Parties."

RECITALS

WHEREAS, MP is an investor-owned electric utility that owns electric generation, transmission and distribution facilities and is engaged in the generation, transmission and sale of electric power and energy to retail customers in the state of Minnesota and to wholesale customers in Minnesota and throughout the Midwest; and

WHEREAS, Great River Energy ("GRE") is an electric cooperative company that owns electric generation and transmission facilities and is engaged in the generation, transmission, and sale of electric power and energy at wholesale in the state of Minnesota; and

WHEREAS, MP and GRE, operate their respective electric systems within the interconnected electrical transmission network in accordance with the requirements and guidelines set forth by the Mid-Continent Area Power Pool ("MAPP"); and

WHEREAS, MP and GRE desire to jointly commit their generating and purchased power resources for load and capability requirements under MAPP; and

WHEREAS, Split Rock is a limited liability company, of which GRE is a member; and

WHEREAS, MP desires to enter into a power coordination agreement with Split Rock setting out the terms and conditions under which MP will, among other things, make its generating and purchased power resources available to Split Rock, along with GRE's generating and purchased power resources, to meet the End-Use Load Obligations of MP and GRE, and Split Rock will, among other things, be responsible for meeting MP's load and capability responsibilities under MAPP.

NOW, THEREFORE, in consideration of the premises and for other good and valuable consideration, the receipt, adequacy and sufficiency of which are hereby acknowledged, and intending to be legally bound, MP and Split Rock hereto agree as follows:

SECTION 1.
TERM OF AGREEMENT AND DEFINITIONS

Section 1.01 Term of Agreement.

This AGREEMENT shall become effective on the latest of: (1) the date this AGREEMENT is approved by the Administrator of the RUS or accepted for filing by any other regulatory agencies as required by law; or (2) the date hereof. After such effective date, this AGREEMENT shall remain in effect until terminated by either party in accordance with this AGREEMENT.

Section 1.02 Purpose of Agreement.

The purpose of this AGREEMENT, among other things, is to establish the terms and conditions under which Split Rock shall: (i) be responsible for the commitment of MP's Generation Resources, and the procurement of capacity and energy, with the Generation Resources of GRE to serve safely and reliably, the full requirements of MP's End-Use Loads and GRE's End-Use Loads; and (ii) be a member of MAPP and undertake those MAPP obligations and responsibilities necessary for Split Rock to assume the MAPP End-Use Load Obligation for the combined electric loads of MP and GRE and to represent the interests of MP and GRE in MAPP and its subcommittees for that purpose. Moreover, this agreement provides the foundation for meeting the Joint Reporting of Load and Capability requirements set forth in the MAPP Restated Agreement, Section 6.4.3 and the MAPP Generation Reserve Sharing Pool Handbook, Section 4.2.1.7.

Section 1.03 Definitions.

The following terms, when used herein, shall have the meanings specified below

a. "Due Diligence" means the exercise of good faith efforts to perform a required or requested act on a timely basis and in accordance with Good Utility Practice, using the technical and human resources reasonably available.

b. "End-Use Load" means the load of persons or other entities that purchase or produce electric energy for their own consumption and not for resale, as defined in the MAPP Restated Agreement or by any similar successor organization.

c. "End-Use Load Obligation" means an obligation imposed by law, regulation or contract to serve End-Use Load within the MAPP Region including any obligation imposed by an assignment of End-Use Load Obligation, as defined in the MAPP Restated Agreement, or by any similar successor organization.

d. "FERC" means the Federal Energy Regulatory Commission (or its successor).

e. "Force Majeure" means any cause beyond the control of the Party affected, including, without limitation, the following: acts of God, fire, flood, landslide, lightning, earthquake, tornado, storm, freeze, drought, blight, famine, epidemic or quarantine; strike, lockout, or other labor difficulty; act or failure to act on the part of any Party that impedes or prevents the others Party's

performance; theft, casualty, accident, equipment breakdown, failure or shortage of, or inability to obtain from usual sources goods, labor, equipment, information or drawings, machinery, supplies, energy, fuel, or materials; embargo; injunction; litigation or arbitration with suppliers or manufacturers; civil unrest, war, civil disorder or disturbance, explosion, or breach of contract by any supplier, contractor, subcontractor, laborer or materialman, including, but not limited to, failure of facilities, flood, earthquake, storm, fire, lightning, epidemic, war, riot, civil disturbance, labor disturbance, sabotage, and restraint by court or public authority.

f. “Generation Resources” means MP’s electric generation resources and/or GRE’s electric generation resources, whether owned or under contract.

g. “Good Utility Practice" means any of the practices, methods, and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period, or any of the practices, methods, and acts which, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at the lowest possible cost consistent with good business practices, reliability, and safety. Good Utility Practice is not intended to be limited to the optimum practice, method, or act to the exclusion of all others, but rather as a spectrum of possible practices, methods, or acts which could have been expected to accomplish the desired result at the lowest possible cost consistent with good business practices, reliability, and safety. Good Utility Practice includes due regard for manufacturers' warranties and the requirements of regulatory authorities.

h. [intentionally left blank]

i. "MAPP" means the Mid-Continent Area Power Pool or its successor organization.

j. "MAPP Agreement" means the Mid-Continent Area Power Pool Restated Agreement dated January 12, 1996, as amended, and as may be further amended from time to time.

k. ”MAPP Generation Reserve Sharing Pool Handbook” means the Mid-Continent Area Power Pool Handbook that sets forth the basic requirements for the approval of joint reporting of load and capacity between two or more MAPP End-Use Load Members.

l. [intentionally left blank]

m. [intentionally left blank]

n. “Power” means either electric capacity or energy or both.

o. “RUS” means the U.S.D.A. Rural Utilities Service or its successor.

p. [intentionally left blank]

SECTION 2.[intentionally left blank]

SECTION 3.

PARTIES' RESPONSIBILITIES

Section 3.01 Split Rock Responsibilities.

Section 3.01.1 The responsibilities of Split Rock shall include:

a. Establish procedures and operating protocols consistent with the provisions hereof governing the coordination of MP's Generation Resources and GRE's' Generation Resources to serve End-Use Load pursuant to this AGREEMENT.

b. [intentionally left blank]

c. [intentionally left blank]

d. Represent MP's End-Use Load interests in NERC and MAPP and perform, on behalf of MP, those responsibilities and undertake those obligations that are consistent with and required by such organizations and/or councils.

e. [intentionally left blank]

f. Take such other actions and perform such other duties as may be required in connection with the terms of this AGREEMENT and approved by MP and GRE.

Section 3.01.2 Limitation on Split Rock Responsibilities. Nothing in this AGREEMENT or otherwise shall be interpreted as requiring that Split Rock assume any responsibility, and Split Rock shall not have any responsibility, for the physical operation and/or maintenance of any of MP's Generation Resources or facilities, employees, fuel arrangements or obligations, economic dispatch of MP Generation, control area operation, or for any MP debt or other obligations related to ownership or operation and maintenance of those resources or facilities.

Section 3.02 MP Responsibilities.

The responsibilities of MP under this AGREEMENT shall include but are not necessarily limited to the following:

a. [intentionally left blank]

b. [intentionally left blank]

c. MP shall be responsible for the costs of owning and operating its control center and providing or obtaining from third parties all necessary control area functions and services. MP shall provide to Split Rock control center information and coordinate control area functions and services with Split Rock and/or GRE as reasonably necessary for Split Rock to fulfill its obligations hereunder.

d. MP shall coordinate with Split Rock, and may designate Split Rock as its agent, to obtain from third parties the transmission service necessary to implement this AGREEMENT.

SECTION 4.
DISPATCH OF MEMBERS' GENERATION RESOURCES

Section 4.01 Dispatch and Scheduling.

a. Split Rock shall provide services that are necessary and appropriate to commit and dispatch the Generation Resources of MP and GRE to serve the combined End-Use Load of MP and GRE. Split Rock shall not commit and dispatch MP Generation Resources to meet loads that are not End-Use Loads of MP and GRE. MP operators may take any and all actions that they reasonably believe, based on the circumstances and information available to them at the time, are necessary and appropriate to avoid or alleviate emergency conditions or to protect the safety of persons or property.

b. MP shall provide and maintain, at its own expense, in accordance with specifications and procedures satisfactory to meet its obligations hereunder, such telecommunications and other facilities at its premises as are necessary to transfer data relating to its Generation Resources, and other necessary operating data, to and from Split Rock.

c. The Parties shall develop and maintain any necessary operating guidelines to implement the provisions of this Agreement. Such operating guidelines shall include a priority of the use of MP Generation Resources for MP End-Use Loads and GRE Generation Resources for GRE End-Use Loads.

Section 4.02 Ownership and Maintenance of Generation Resources.

a. MP shall have the responsibility, at its cost, to operate and maintain its Generation Resources, including maintaining any necessary accreditation, consistent with Good Utility Practice and any operating practices or protocols implemented by Split Rock pursuant to this AGREEMENT.

b. MP may retire or dispose of any of its existing Generation Resources, or choose not to renew or extend the contractual arrangements for Generation Resources under contract, upon reasonable notice to Split Rock and GRE, and MP shall have no obligation to Split Rock or GRE to replace any retired, disposed or lapsed Generation Resource.

c. Should an event of Force Majeure or other event of partial or complete outage of MP's Generation Resources occur, MP shall immediately notify Split Rock and GRE of such event, its expected duration, and MP's intentions to address such event. During such Force Majeure events, MP shall take all reasonable actions, in coordination with Split Rock, to restore the operation and rating of any Generation Resource adversely affected by such Force Majeure events.

d. Should MP experience an outage of any of its Generation Resources that may affect the ability of Split Rock to fulfill its responsibilities under this AGREEMENT or any applicable prevailing regional reliability requirements, MP will take any actions that it reasonably believes are necessary and appropriate to obtain replacement capacity or energy from other resources.

e. MP shall be responsible for procuring any fuel or other resources needed for the operation of its Generation Resources and for maintaining and administering any contacts for the purchase and delivery of such fuel or resources.

SECTION 5.

END-USE LOAD SERVICE

Section 5.01 Split Rock Obligations.

As provided for in Section 6.4.3(f) of the MAPP Restated Agreement, MP hereby assigns to Split Rock, and Split Rock hereby accepts such assignment from MP, all of MP's End-Use Load Obligation. Notwithstanding Split Rock's obligations hereunder, MP at all times retains all of the rights and obligations it may have under its own contracts to provide electric service to MP's End-Use Loads, including contracts with municipal electric utility customers.

Section 5.02. [intentionally left blank]

Section 5.03 Generation Resource Obligations.

MP shall designate a level of Generation Resources, and be required to operate and maintain such Generation Resources consistent with Good Utility Practices, sufficient to meet MP's contribution to Split Rock's End-Use Load Obligation. Unless otherwise agreed, MP shall be solely responsible for any costs incurred by Split Rock as a result of MP's failure to meet its obligations herein.

SECTION 6. [intentionally left blank]

SECTION 7.

MEMBERSHIP IN MAPP

Section 7.01 End-Use Load and Reliability Membership.

In recognition of the End-Use Load Obligation assumed by Split Rock under this AGREEMENT, Split Rock shall apply for and become an End-Use Load and Reliability Member of MAPP, taking responsibility for the End-Use Loads and the Generation Resources of MP and satisfying MP's related obligations under the MAPP Agreement.

Section 7.02 MAPP Application.

MP and Split Rock, in conjunction with the other Members, shall mutually cooperate in preparation of Split Rock's MAPP membership application, and MP shall support the application through the MAPP approval process. As part of that process, MP shall prepare and submit to MAPP an application for a change in its MAPP membership status consistent with Split Rock's assumption of End-Use Load Obligation and Reliability Membership for MP's End-Use Loads and Generation Resources. Notwithstanding the foregoing, MP intends to participate in MAPP as a Transmission Owning Member.

Section 7.02.1 Change in MAPP Membership Status.

If, during the term of this AGREEMENT, (a) MP ceases to be a MAPP Member, (b) the MAPP Agreement is terminated or materially modified, (c) some or all of MAPP’s functions and responsibilities are assumed under a successor or different organization or entity, all terms and conditions with respect to MAPP shall remain in force until new terms and conditions are mutually agreed upon by Split Rock, GRE and MP.

Section 7.03 Costs of MAPP Membership.

The costs of Split Rock's participation in MAPP shall be charged to MP and GRE in proportion to their individual shares of Split Rock’s End-Use Load Obligation.

SECTION 8.

STANDARDS FOR SYSTEM OPERATIONS

Section 8.01 Operating Standards.

To the extent applicable, MP shall operate its electrical systems and Split Rock shall carry out its responsibilities under this AGREEMENT consistent with Good Utility Practice and in compliance with NERC and MAPP requirements.

Section 8.02 [intentionally left blank]

Section 8.03 Information Requirements.

The Parties shall maintain records reflecting hourly schedules of power and energy generated and actual deliveries of power and energy from MP Generation Resources, and shall make such records available to each other and to Split Rock, GRE and MP upon request. Nothing in this AGREEMENT shall obligate either Party to retain records longer than the period prescribed by FERC, RUS, MAPP, or other applicable regulatory body, reliability council or operational standard.

SECTION 9.
TERMINATION

Section 9.01 Notice of Termination.

This AGREEMENT may be terminated by MP upon one hundred and eighty (180) days' notice of termination. Termination will be effective on the first day of the month, and written notice of termination must be given at least one hundred and eighty days prior to the first day of the month that MP intends for its notice to become effective and for the AGREEMENT to terminate. Upon termination in accordance with this Section 9.01, MP shall be excused and relieved of all obligations and liabilities under this AGREEMENT, except those liabilities incurred before the effective date of termination or as a result of the termination. Each Party shall use every reasonable effort to mitigate any damages resulting from a breach and/or termination of this AGREEMENT.

Section 9.02 Effect of Termination.

If, upon termination of this AGREEMENT, the Parties are unable to mutually agree as to the effects of termination, any dispute over the effects of termination shall be resolved through arbitration under Section 11 of this AGREEMENT. The termination of this AGREEMENT shall not discharge either Party from any obligation it owes to the other or to GRE by reason of any transaction, cost, damage, expense, investment, or liability which shall occur or arise prior to such termination. The Parties intend that any such obligation owed (whether the same shall be known or unknown at the termination of this AGREEMENT) shall survive the termination of this AGREEMENT.

SECTION 10.
GENERAL

Section 10.01 Continuity of Operation.

a. Unless otherwise directed by Split Rock as part of its integrated dispatch, the operating performance of MP's electrical system under this AGREEMENT shall be continuous, except for the following:

(1) Interruptions or reductions due to Force Majeure, which, by exercise of due diligence and foresight, could not reasonably have been avoided.

(2) Interruptions or reductions due to operation of devices installed for power system protection.

(3) Temporary interruptions or reductions which are necessary or desirable for the purposes of maintenance, repairs, replacements, installation of equipment or investigation and inspection. MP will give Split Rock and GRE reasonable advance notice of such interruptions or reductions, except in cases of emergency make such advance notice impracticable as reasonably determined by MP, and MP will use best reasonable efforts to remove the cause thereof as quickly as practicable under the circumstances.

b. The Party prevented from performing its obligations for any of the reasons set forth in Section 10.01(a), above, shall exercise Due Diligence in attempting to remove the cause of its failure to perform, and nothing herein shall be construed as permitting that Party to continue to fail to perform after said cause has been removed; however, the Party shall not be obligated to agree to any settlement of a strike or labor dispute which, in that Party's sole discretion, may be inadvisable or detrimental to its interests.

Section 10.02. Character of Power and Energy.

All deliveries of electric power and energy hereunder shall be of the character commonly known as three-phase, sixty-Hertz power and energy, unless explicitly stated otherwise.

Section 10.03 Successors and Assigns.

This AGREEMENT shall be binding upon the respective Parties, their successors and assigns, on and after the effective date hereof. None of the provisions of this AGREEMENT, whether in whole or in part, shall be assigned nor their performance delegated by any Party to any third party without the written consent of the other, which shall not be unreasonably withheld, unless such assignment is to an affiliate or successor that assumes all of the rights and obligations hereunder so long as such assignment would not adversely affect any of the federal, state or reliability council approvals or findings required or in place for Split Rock's operations under this AGREEMENT.

Section 10.04 No Third Party Beneficiary.

No provision of this AGREEMENT shall in any way inure to the benefit of any customer, or any other third party, so as to constitute any such person as a third party beneficiary under this AGREEMENT, or of any one or more of the terms hereof, or otherwise give rise to any cause of action in any person not a Party hereto.

Section 10.05 Notices.

Any notice, demand, request, or communication required or authorized by this AGREEMENT shall be either hand-delivered or mailed by certified mail, return-receipt requested, with postage prepaid, to:

Minnesota Power, Inc.
30 West Superior Street
Duluth, Minnesota 55802
Attn: Donald J. Shippar

Great River Energy
17845 East Highway 10
P.O. Box 800
Elk River, MN 55330-0800
Attn: Jim Van Epps

with copies to:

Steven W. Tyacke
Assistant General Counsel
Minnesota Power, Inc.
30 West Superior Street
Duluth, Minnesota 55802

David Saggau
General Counsel
Great River Energy
17845 East Highway 10
P.O. Box 800
Elk River, MN 55330-0800

On behalf of Split Rock to:

Ron Larson
President and CEO
Split Rock Energy LLC
301 4th Avenue South – Suite 860N
Minneapolis, MN 55415

The designation and titles of the persons to be notified or the address of such person may be changed at any time by written notice.

Section 10.06 Billing and Payment Procedure.

Unless governed by separate written agreement, the Parties shall bill and make payments in accordance with the following procedures:

a. The Party (selling Party) providing any billable services to the other Party (buying Party) shall issue an invoice by the fifteenth of each month for services provided during the previous month.

b. The buying Party's payments to the selling Party shall be due if by mail at the selling Party's general office, or if by wire transfer to a bank and account named by the selling Party, no later than fifteen days following the date of the invoice, but such payment shall not be due before the 20th day of the month. The buying Party shall have the right to dispute the amount of any such invoice by protest on or before the payment date, but such dispute shall not relieve the buying Party of the obligation to pay the entire amount, including the disputed portion, by the payment date. If such due date falls on a Saturday, Sunday, or holiday, such due date shall be the next working day. Payments received after the due date shall be considered late and shall bear interest on the payment

due at a rate equal to the rate set out in Section 35.19a(a) of FERC's Regulations, as such section may be amended from time to time, for the number of days elapsed from and including the day after the due date, to and including the payment date.

c. Upon the failure of the buying Party to pay all amounts due within thirty days of the due date, the buying Party shall be in default.

Section 10.07 Right of Access; Right to Audit.

a. Each Party, after receiving reasonable notice from another Party, will give authorized agents and employees of the other the right to enter its premises at all reasonable times for the purpose of reviewing hourly metering and scheduling records, for reading or checking meters, or for constructing, testing, repairing, renewing, exchanging, or removing any or all of its equipment which may be located on the property of the other, or for any work incident to performing system operations under this AGREEMENT or rendering service contracted for.

b. Each Party shall have the right from time to time, upon written request and at its own expense, to audit the other Party's books and records to verify the information provided by that Party as required under this AGREEMENT.

Section 10.08 Drafting Responsibility.

No Party shall be deemed solely responsible for drafting all or any portion of this AGREEMENT and, in the event of a dispute, responsibility for any ambiguities arising from any provision of this AGREEMENT shall be equally shared.

Section 10.09 Captions.

All titles, subject headings, section titles, and similar items are provided for the purpose of reference and convenience and are not intended to be inclusive, definitive, or to affect the meaning of the contents or scope of this AGREEMENT.

Section 10.10 Governing Law.

This AGREEMENT shall be interpreted and governed by the laws of the state of Minnesota, or the laws of the United States, as applicable.

Section 10.11 Regulation.

This AGREEMENT, and all rights and obligations of MP hereunder is subject to all applicable state and federal laws and regulations. The Parties agree to defend this AGREEMENT before any regulatory body, and to cooperate to seek to obtain any necessary regulatory approvals. Each Party will be responsible for its own fees or costs associated with obtaining any such approvals.

Section 10.12 No Joint Venture or Partnership.

No provision of this AGREEMENT shall be interpreted to mean or imply that the Parties, or MP and GRE, have established or intend to establish a joint venture or a partnership.

Section 10.13 Amendment.

Any amendment, alteration, variation, modification, or waiver of the provisions of this AGREEMENT shall be valid only after it has been signed by the Parties and, if required, approved or accepted by any regulatory body with jurisdiction over MP or this AGREEMENT.

Section 10.14 Severability.

If any governmental agency or court of competent jurisdiction holds that any provision of this AGREEMENT is invalid, or if, as a result of a change in any federal or state law or constitutional provision, or any rule or regulation promulgated pursuant thereto, any provision of this AGREEMENT is rendered invalid or results in the impossibility of performance thereof, the remainder of this AGREEMENT shall not be affected thereby and shall continue in full force and effect. In such an event, the Parties shall promptly renegotiate in good faith new provisions to restore this AGREEMENT as nearly as possible to its original intent and effect.

Section 10.15 Superseding Effect.

This AGREEMENT supersedes and has merged into it all prior oral and written agreements on the same subjects by or among the Parties, with the effect that this AGREEMENT shall control.

SECTION 11.
ARBITRATION

Section 11.01 Arbitration.

Any controversy or claim arising out of or relating to this AGREEMENT or the breach hereof which cannot be resolved amicably shall be settled by arbitration. A Party desiring to invoke this arbitration provision shall serve written notice upon the other of its intention to do so. The arbitration shall be conducted in accordance with the Commercial Arbitration Rules of the American Arbitration Association then prevailing. The American Arbitration Association shall administer the arbitration and act as appointing authority of the arbitrator. Each Party shall bear its own costs and expenses of the arbitration, including attorneys and expert witness fees, and shall equally share the expense of the arbitrator and the administrative expenses of the arbitration. The arbitration shall be governed by the United States Arbitration Act, 9 U.S.C. Sections 1-16. The award of the arbitrator shall be final, and judgment on the award rendered by the arbitrator may be entered by any court having jurisdiction. The arbitration shall be conducted in Minneapolis, Minnesota unless the Parties agree otherwise.

Section 11.02 Effect of Termination on Arbitration.

This Section 11 shall survive the termination of this AGREEMENT as necessary to resolve any outstanding disputes that arose prior to the time that termination of this AGREEMENT became effective as well as any disputes involving termination, as provided for in Section 9.02 herein

[The next page is the signature page]

IN WITNESS WHEREOF, the Parties have caused this AGREEMENT to be executed by their duly authorized representatives as of the day and year first above written.

MINNESOTA POWER, INC.

By: /s/ Donald J. Shippar

Title: President & CEO

SPLIT ROCK ENERGY LLC

By: /s/ Ronald Larsen

Title: President & CEO

[SIGNATURE PAGE TO WHOLESALE POWER COORDINATION AND DISPATCH AGREEMENT – FIRST REVISED RATE SCHEDULE FERC NO. 175]

Exhibit 10(p)

CONFIDENTIAL TREATMENT

AMENDED AND RESTATED

WITHDRAWAL AGREEMENT

BY AND BETWEEN

GREAT RIVER ENERGY

AND

MINNESOTA POWER

DATED: JANUARY 30, 2004

CONFIDENTIAL TREATMENT

TABLE OF CONTENTS

*** TEXT HAS BEEN OMITTED PURSUANT TO A REQUEST FOR CONFIDENTIAL TREATMENT AND HAS BEEN FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION.**

AMENDED AND RESTATED
WITHDRAWAL AGREEMENT

THIS AMENDED AND RESTATED WITHDRAWAL AGREEMENT (this "**Agreement**"), is entered into January 30, 2004, to be effective from and after December 12, 2003 (the "**Effective Date**") by and between **Minnesota Power**, a division of ALLETE, Inc., a Minnesota corporation, an investor-owned utility ("**MP**") and **Great River Energy**, a Minnesota cooperative corporation ("**GRE**").

RECITALS

A. Split Rock Energy LLC is a Minnesota limited liability company ("**SRE**") (i) owned equally (50%/50%) by MP and GRE (MP and GRE are each individually a "**Member**," and may collectively be referred to herein as the "**Members**"), and (ii) engaged in the business of providing Core Operations (defined below) and Trading Operations (defined below).

B. SRE is governed pursuant to that certain Member Control Agreement dated April 14, 2000, entered into by MP and GRE, as amended by (i) that certain letter agreement dated February 5, 2002, between MP and GRE (concerning withdrawal by a Member of SRE), and (ii) this Agreement (the "**Member Control Agreement**").

C. MP gave notice to GRE of its desire to withdraw from its membership in SRE, which notice is acknowledged by the parties hereto to have been properly given, even if not strictly in accordance with the provisions of the Member Control Agreement. MP and GRE agree said notice is deemed to have been given on November 1, 2003.

D. MP and GRE entered into that certain Interim Agreement dated November 18, 2003, as amended by Amendment No. 1 dated November 21, 2003, Amendment No. 2 dated December 5, 2003, Amendment No. 3 dated December 23, 2003 and Amendment No. 4 dated January 30, 2004 (collectively, the "**Interim Agreement**"), pursuant to which MP and GRE became bound to certain agreements arising under Sections 2 (operating expenses; Net Income and Losses from Power Trading Transactions; negotiation of a withdrawal agreement), 3 (indemnity), and 4 (termination), of the Interim Agreement (the "**Binding Provisions**").

E. MP and GRE shall be bound to their covenants set forth in the Binding Provisions of the Interim Agreement for the period from and after November 1, 2003, through the Execution Date (defined below). At and after the Closing Date of this Agreement, the Interim Agreement, this Agreement and the Ancillary Documents (defined below) shall control all relations of MP and GRE for the respective time periods set forth therein and herein. To the extent this Agreement conflicts with the Interim Agreement, this Agreement shall govern.

F. MP and GRE entered into that certain Withdrawal Agreement dated December 12, 2003, as amended by Amendment No. 1 dated December 23, 2003 (the "**Withdrawal Agreement**") pursuant to which MP and GRE set forth the terms by which, among other things, it was anticipated that MP would withdraw from its membership in SRE (the "**MP Withdrawal**").

G. Subsequent to the execution and delivery of the Withdrawal Agreement it was determined that additional time would be required to obtain a prior consent order from FERC (as defined below) pursuant to applicable law, including Section 203 of the Federal Power Act, before the MP Withdrawal could be lawfully effected (the "**FERC Approval**").

H. As a consequence of delay occasioned by the FERC Approval process, MP and GRE have hereby amended and restated the Withdrawal Agreement in its entirety to (i) set forth the amended and restated agreement of MP and GRE with respect to the MP Withdrawal, (ii) terminate the Withdrawal Agreement in its entirety, and (iii) establish the further understandings and covenants by which certain actions of MP and GRE will (x) restate and revise the existing business relations between MP and GRE as Members of SRE pending the FERC Approval, and (y) amend the Member Control Agreement to incorporate the terms of this Agreement.

I. The initial actions taken by MP and GRE to effect the matters set forth in Recital H above shall occur at and upon January 31, 2004 at 11:59 p.m. CST (the "**Execution Date**") to be followed by the Closing (defined below) on the Closing Date, upon satisfaction of the conditions to Closing set forth in Article 11 of this Agreement.

J. Within five (5) business days after receipt of the FERC Approval, and the satisfaction of the conditions set forth in Article 11 hereof, MP will withdraw as a Member of SRE effective on the Closing Date at 11:59 P.M. (CST) (the "**Withdrawal Effective Time**") and, effective upon the Closing of this Agreement and at the Withdrawal Effective Time, MP shall no longer be a Member of SRE nor have any further obligations under the Member Control Agreement or any other SRE governing document or ancillary agreement, instrument or document (other than the Ancillary Documents) arising from, in connection with or pursuant to the organization, operation or continuing operations of SRE, except as set forth herein and/or pursuant to the Binding Provisions of the Interim Agreement; provided, however, that nothing herein shall affect the validity or continued effectiveness of the Margin Agreement between the Members.

K. Subject to the Closing of this Agreement, the timing and method of withdrawal by MP as set forth in this Agreement and the Interim Agreement constitutes a proper amendment and/or waiver of the withdrawal provisions of the Member Control Agreement with respect to MP.

L. From and after the Closing Date, all rights and obligations of MP arising in connection with SRE shall be determined solely by the terms of this Agreement and the documents, instruments, agreements and schedules hereto (collectively, the "**Ancillary Documents**"), including any rights and obligations to or from SRE, GRE and any and all Third Parties.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing Recitals, which are incorporated herein as essential terms of this Agreement, the mutual covenants and agreements

hereinafter contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

ARTICLE 1

DEFINED TERMS

For purposes of this Agreement and the Schedules to this Agreement, the following terms have the meanings specified:

"***AAA Rules***" shall have the meaning set forth in Section 7.05(b) of this Agreement.

"***Accounting Arbitrator***" shall have the meaning set forth in Section 3.02(b) of this Agreement.

"***Administrative Fees***" or "***Administrative Fee***" shall have the meaning set forth in Section 2.01(d) of this Agreement.

"***Agreement***" shall have the meaning set forth in the Preamble to this Agreement.

"***Ancillary Documents***" shall have the meaning set forth in the Recitals to this Agreement.

"***Assets***" shall have the meaning set forth in Section 2.01(b) of this Agreement.

"***Associated Indemnified Parties***" shall have the meaning set forth in Section 7.01 of this Agreement.

"***Authorized Representatives***" shall have the meaning set forth in Section 13.03 of this Agreement.

"***Binding Provisions***" shall have the meaning set forth in the Recitals to this Agreement.

"***Business***" shall mean the Core Operations and Trading Operations of SRE, wherever its operations are conducted.

"***Capital Account***" means, for purposes of Section 3.01 and other provisions of this Agreement and the Ancillary Documents, the capital accounts of the Members derived by generally accepted accounting principles consistently applied by SRE, as maintained on a "book" basis (as opposed to any tax basis capital account), which includes the initial investments of the Members and the subsequent activities of SRE from and after such investments.

"***Capital Vig***" shall have the meaning set forth in Section 3.01(b) of this Agreement.

"***CTU***" shall have the meaning set forth in Section 5.03 of this Agreement.

"***Closing***" shall have the meaning set forth in Section 11.01 of this Agreement.

"***Closing Date***" shall have the meaning set forth in Section 11.01 of this Agreement.

"***CoBank Credit Facility***" means that certain Credit Agreement dated August 16, 2000 as amended by First Amendment to Credit Agreement dated August 15, 2001, by Second Amendment to Credit Agreement dated August 14, 2002, by Third Amendment to Credit Agreement dated August 13, 2003, by Fourth Amendment to Credit Agreement dated November 12, 2003, and by Fifth Amendment to Credit Agreement dated January 30, 2004, by and between SRE and the financial institutions from time to time party thereto and CoBank ACB in its capacity as agent for the Banks as Administrative Agent, (as such terms are defined in the CoBank Credit Facility).

"***Code***" means the Internal Revenue Code of 1986, as amended, and any successor thereto. Any reference to specific Sections of the Code shall be to the Section as it now exists and to any successor provision.

"***Confidential Information***" shall have the meaning set forth in Section 13.03 of this Agreement.

"***Consents***" shall have the meaning set forth in Section 9.02 of this Agreement.

"***Core Operations***" means the various core utility operations SRE conducts on behalf of its Members, including but not limited to joint and economical dispatch of the combined generation resources of its Members to optimally serve the native load of each, marketing and selling to third parties the excess generation of its Members not used to serve Members' native load customers, and purchase and brokering of energy from third parties for least cost supply to its Members to serve their native load customers, and related services as are performed by SRE.

"***Effective Date***" shall have the meaning set forth in the Preamble to this Agreement.

"***Estimated Execution Date MP Capital Account***" has the meaning set forth in Section 3.01(a) of this Agreement.

"***Exclusive Member Sales***" are capacity and energy sales contracts that Members have entered into prior to becoming SRE Members, or direct sales by a Member to another Member or any Third Party that have been approved by the SRE Board of Governors.

"***Exclusive Purchase***" is a purchase that flows directly to a specific SRE Member.

"***Execution Date***" shall have the meaning set forth in the Recitals to this Agreement.

"***Execution Date MP Capital Account***" has the meaning set forth in Section 3.01(b) of this Agreement.

"***Execution Date MP Capital Account Distribution***" shall have the meaning set forth in Section 3.01(a) of this Agreement.

"***FERC***" means the Federal Energy Regulatory Commission, an agency of the United States government.

"***FERC Approval***" shall have the meaning set forth in the Recitals to this Agreement.

"***FERC Filing***" shall have the meaning set forth in Section 6.05 of this Agreement.

"***FERC Order***" shall have the meaning set forth in Section 6.05 of this Agreement.

"***GAC***" shall have the meaning set forth in Section 5.03 of this Agreement.

"***GRE***" shall have the meaning set forth in the Preamble to this Agreement.

"***GRE Attorney Fees***" shall have the meaning set forth in Section 7.01(e) of this Agreement.

"***GRE Indemnified Party***" or "***GRE Indemnified Parties***" shall have the meaning set forth in Section 7.04(a) of this Agreement.

"***Governmental Body***" means any:

(i) nation, state, county, city, town, village, district or other jurisdiction of any nature;

(ii) federal, state, local, municipal, foreign or other government;

(iii) governmental or quasi-governmental authority of any nature (including any governmental agency, branch, board, commission, department, instrumentality, office or other entity, and any court or other tribunal);

(iv) multinational organization or body; and/or

(v) body exercising, or entitled or purporting to exercise, any administrative, executive, judicial, legislative, police, regulatory or taxing authority or power of any nature.

The foregoing definition of Governmental Body does not and shall not be deemed to include MAPP or MAIN.

"IMO" means Ontario Independent Market Operator.

"***Indemnified Party***" or "***Indemnifying Party***" shall have the meaning set forth in Section 7.04(c) of this Agreement.

"***Interim Agreement***" shall have the meaning set forth in the Recitals to this Agreement.

"***Interim Period***" shall mean the period commencing November 1, 2003, through the Execution Date.

"***Joint Reporting Transmission***" means the MAPP firm transmission service required by the MAPP reliability handbook rules to support exchanges of capacity and energy between MP and GRE during such time as SRE is engaged in joint reporting of load and capability for MP and GRE.

"***Kendall County***" means the Kendall County, Illinois Unit No. 3 generator, from which RREC purchases and remarkets power on the wholesale market.

"***Loss***" or "***Losses***" shall have the meaning set forth in Section 7.01 of this Agreement.

"***MAIN***" means MidAmerica Interconnected Network.

"***MAPP***" means the Mid-Continent Area Power Pool.

"***MISO***" means the Midwest Independent System Operator, Inc., a FERC approved regional transmission organization.

"***MLLCA***" means the Minnesota Limited Liability Company Act, Chapter 322B of the Minnesota Statutes.

"***MP***" shall have the meaning set forth in the Preamble to this Agreement.

"***MP-GRE Block A and B Agreements***" means the Block A and Block B Transaction and Confirmation Agreements dated August 28, 2003 between MP and GRE.

"***MP Indemnified Party***" or "***MP Indemnified Parties***" shall have the meaning set forth in Section 7.04(b) of this Agreement.

"***MP Least Cost Supply***" means such MP transactions for power, energy, transmission and financial products entered into for supply of its native utility end use load obligations.

"***MP Representative***" shall have the meaning set forth in Section 13.04(b) of this Agreement.

"***MP Withdrawal***" shall have the meaning set forth in the Recitals to this Agreement.

"***MPUC***" shall mean the Minnesota Public Utilities Commission, a regulatory political subdivision of the State of Minnesota.

"***Management Employees***" shall have the meaning set forth in Section 4.01 of this Agreement.

"***Margin Agreement***" means that certain Margin Agreement between MP and GRE dated February 22, 2001.

"***Member***" or "***Members***" shall have the meaning set forth in the Recitals to this Agreement.

"***Member Control Agreement***" shall have the meaning set forth in the Recitals to this Agreement.

"***Membership Interest Payment***" shall have the meaning set forth in Section 2.02(b) of this Agreement.

"***Membership Interest Transfer Order***" shall have the meaning set forth in Section 6.05(i) of this Agreement.

"***Membership Interest***" or "***Membership Interests***" shall mean the entire membership interest of MP in SRE, as that term is defined in Minn. Stat. § 322B.03 subd. 31 (2003).

"***Net Income***" and "***Net Losses***" means, for each taxable year or other period, an amount equal to SRE's taxable income or loss, as the case may be, for the year or other period, determined in accordance with Section 703(a) of the Code (including all items of income, gain, loss or deduction required to be stated separately under Section 702(a) of the Code), with the following adjustments:

(1) Any income of SRE that is exempt from federal income tax and not otherwise taken into account in computing Net Income or Net Losses will be added to taxable income or shall reduce a loss;

(2) Any expenditures of SRE described in Code Section 705(a)(2)(B) or treated as Section 705(a)(2)(B) expenditures under Treasury Regulations Section 1.704-1(b)(2)(iv)(i), and not otherwise taken into account in computing profits or losses, will be subtracted from taxable income or loss;

(3) Any items which are specially allocated to a Member of SRE as required by applicable provisions of the Code, will not affect calculations of Net Income or Net Losses; and

(4) For this purpose, any deduction for a loss on sale or exchange of SRE property which is disallowed to SRE under Code Section 267(a)(1) or Section 707(b) shall be treated as a Code Section 705(a)(2)(B) expenditure.

"***Order***" means an action or decision of the Governmental Body as to which (i) no request for a stay is pending, no stay is in effect, and any deadline for filing such request that may be designated by any applicable law has passed, (ii) no petition for rehearing or reconsideration or application for review is pending and the time for the filing of such petition or application has passed, (iii) the Governmental Body does not have the action or decision under reconsideration on its own motion and the time within which it may effect such reconsideration has passed, and (iv) no judicial appeal is pending or in effect and any deadline for filing any such appeal that may be designated by statute or rule has passed.

"***Overlap Period***" shall have the meaning set forth in Section 13.04(b) of this Agreement.

"***Power Trading Transaction***" means power Trading Operations conducted by SRE with or between non-Member Third Parties (i.e., not involving any Member), but excluding Core Operations and any Exclusive Member Sales or Exclusive Purchases.

"***Proceeding***" means any claim, suit, litigation, arbitration, hearing, audit, investigation, Order, or other action (whether civil, criminal, administrative or investigative) noticed, commenced, brought, conducted, or heard by or before, or otherwise involving, any Governmental Body or arbitrator.

"***RREC***" means Rainy River Energy Corporation, a Minnesota corporation that is a subsidiary of MP.

"***Required Notice Information***" shall have the meaning set forth in Section 7.04(a) of this Agreement.

"***Retained MP Capital Account***" shall have the meaning set forth in Section 3.01(b) of this Agreement.

"***SRE***" shall have the meaning set forth in the Recitals to this Agreement.

"***Statement of Execution Date MP Capital Account***" shall have the meaning set forth in Section 3.02(a) of this Agreement.

"***Tangible Assets***" shall have the meaning set forth in Section 2.01(b)(i) of this Agreement.

"***Tax***" or "***Taxes***" means any federal, state, local or foreign income, gross receipts, license, payroll, employment, excise, severance, stamp, occupation, premium, windfall profits, environmental (including taxes under Code §59A), customs duties, capital stock, franchise, profits, withholding, social security (or similar), unemployment, disability, real property, personal property, sales, use, transfer, registration, value added, alternative or add-on minimum, estimated, or other tax of any kind whatsoever, including any interest, penalty or addition thereto, whether disputed or not.

"***Tax Matter***" shall have the meaning set forth in Section 13.04(b) of this Agreement.

"***Tax Return***" means any return, declaration, report, claim for refund, or information return or statement relating to Taxes, including any schedule or attachment thereto, and including any amendment thereof.

"***Third Party***" or "***Third Parties***" shall mean any person or entity that is not a party to this Agreement, other than SRE.

"***Trading Operations***" means the various wholesale power trading operations SRE conducts pursuant to its market-based rate tariff on file at the U.S. Federal Energy Regulatory Commission, including but not limited to Power Trading Transactions, wholesale power trading, engaging in the physical and financial trading of electric power and energy, gas trading, hedging, including but not limited to foreign exchange hedges, and trading transmission service under separately tagged and segregated portfolio operations, other than trading done for Core Operations.

"***Withdrawal Agreement***" shall have the meaning set forth in the Recitals to this Agreement.

"***Withdrawal Effective Time***" shall have the meaning set forth in the Recitals to this Agreement.

"***Withdrawal Payment***" shall have the meaning set forth in Section 2.01(c) of this Agreement.

"***Withdrawal Settlement***" shall have the meaning set forth in Section 2.01(c) of this Agreement.

ARTICLE 2

TRANSFER OF MP FINANCIAL RIGHTS AND CERTAIN BUSINESS ASSETS; MP WITHDRAWAL PAYMENTS; WITHDRAWAL

2.01 **Assignment of MP Financial Rights and Certain Business Assets**. Effective at and upon the Execution Date:

(a) Assignment of Financial Rights. Except as contemplated by the terms of this Agreement, MP hereby assigns to GRE, free and clear of all liens, claims, encumbrances, restrictions and security interests, any and all financial rights in the profits and losses of SRE, and any distributions thereof, to which MP would otherwise be entitled under the Member Control Agreement or the MLLCA. This assignment by MP shall (i) be governed by Section 322B.31 of the MLLCA, and (ii) serve to amend the following provisions of the Member Control Agreement: Section 4.3 (Allocations of Net Income and Net Losses), Section 4.5 (Mandatory Distributions), Section 4.6 (Distributions in Kind), Section 4.7(c) (Qualified Income Offset), Section 4.9 (Discretionary Adjustment) and Section 4.10 (Special Allocations to Founding Members – New Member Fee; Distributions). Based on and in clarification of the foregoing, except as provided in this Agreement, upon and after the Execution Date MP shall:

(A) have no further right under the Member Control Agreement to (i) any further allocations of net income or net losses, (ii) mandatory or permissive distributions, (iii) distributions in kind, or (iv) special allocations described in Section 4.10 of the Member Control Agreement.

(B) not be (1) allocated any adjustment, allocation or distribution described in Section 4.7(c) of the Member Control Agreement, or (2) subject to any discretionary adjustment described in Section 4.9 of the Member Control Agreement, it being agreed that the matters which take effect pursuant to and on the Execution Date, including without limitation the termination of MP's credit support for the operations of SRE, have and reflect the substantial economic effect of the respective economic interests of MP and GRE from and after the Execution Date and are intended to conform with the requirements of Code Section 704(b) and the regulations thereunder. As a consequence of the foregoing, with respect to any and all allocations of any economic activity of SRE upon and after the Execution Date, MP shall be allocated zero percent (0%) and GRE shall be allocated one hundred percent (100%).

(b) Assignment of Certain Business Assets. MP hereby assigns, relinquishes and transfers any and all right, title and interest in and to the assets set forth below to GRE, or its designee, on the Execution Date (the "**Assets**").

(i) All tangible property of MP used presently in the Business (the "**Tangible Assets**").

(ii) All rights to use and all copies of (i) the ZaiNet software that are conferred by the Sungard (Caminus) license, and (ii) the maintenance and other agreements attached hereto as **Schedule 2.01(b)(ii)**, pursuant to the ZaiNet Novation Agreement substantially in the form attached hereto as **Exhibit A**.

(iii) Any software (other than the ZaiNet software referenced above) developed or modified by SRE and/or MP for use by SRE as set forth on **Schedule 2.01(b)(iii)**. This software includes, without limitation, all source code, object code other associated documentation, and new versions, revisions, updates and upgrades currently in the possession of MP; provided, however, that at the Closing GRE shall grant to MP a perpetual, royalty-free, non-transferable license to use and/or modify such software for use in its core least cost supply license and any Trading Operations post-Closing.

(iv) The telephone, servers, office furniture and other personal property, and the leased Dell personal computer equipment and associated software described on **Schedule 2.01(b)(iv)** hereto.

(v) Copies of all data used in the Business that is in MP's control, including but not limited to data contained in MP's data warehouse. MP shall have the right to retain copies of such data without restriction, except as set forth herein.

The Assets shall be relinquished and transferred to GRE or its designee pursuant to a bill of relinquishment and transfer substantially in the form of **Exhibit B** hereto.

(c) Payment of Withdrawal Settlement. In full settlement (the "**Withdrawal Settlement**") of MP's termination of financial participation in SRE and as an advance payment for MP's withdrawal as a party to the Member Control Agreement at the Withdrawal Effective Time, MP has, on or before the Execution Date, remitted a payment to GRE of One Million Nine Hundred Seventy-Nine Thousand Dollars ($1,979,000) (the "**Withdrawal Payment**").

(d) Administrative Fees. On or within five (5) days after the Execution Date, MP shall remit to GRE an administrative fee of $100,000. In the event that the FERC Order is not received on or before April 1, 2004, MP shall remit to GRE an additional administrative fee(s) of $200,000 for the month of April, 2004, and each succeeding month thereafter to the Closing or termination of this Agreement, which payments shall be made respectively on April 30, 2004, and the last day of each such succeeding month thereafter, unless the Closing or a termination of this Agreement occurs within or before any of such months. If the Closing or a termination of this Agreement occurs in any of

the months set forth above, the administrative fee for (i) the month in which the Closing or a termination occurs shall be prorated by the number of days in the month through the Closing Date or the termination date (for example, if the Closing Date is April 16, 2004, the administrative fee for the month will be (16/30 X $150,000)), and (ii) all months after the Closing Date or the termination date shall not become due (any amount that accrues pursuant to the above shall be referred to herein as the "**Administrative Fees**" and any full or partial payment relating to a single month is an "**Administrative Fee**").

2.02 **Withdrawal**.

(a) MP Withdrawal. At and upon the Withdrawal Effective Time, MP shall be deemed to have withdrawn from the Member Control Agreement. As a consequence, MP shall no longer be a Member of SRE or have any further rights or obligations under the Member Control Agreement or any other governing document, or agreement arising from, in connection with, or pursuant to the organization, operation or continuing operations of SRE, except as set forth herein and/or pursuant to the Ancillary Documents and the Binding Provisions of the Interim Agreement.

(b) Relinquishment and Transfer of MP Membership Interest. At and upon the Closing, for a payment by GRE to MP of One Million Dollars ($1 million), plus the Capital Vig (the "**Membership Interest Payment**") and other good and valuable consideration, on the Closing Date, MP shall relinquish and transfer to GRE the Membership Interest of MP in SRE, free and clear of all liens, claims, encumbrances, restrictions and security interests pursuant to a Relinquishment and Assignment of Membership Interest substantially in the form of **Exhibit C** hereto.

ARTICLE 3

RECONCILIATION AND PAYMENT OF MP CAPITAL ACCOUNT

3.01 **Estimated Execution Date MP Capital Account**.

(a) Estimation and Partial Distribution of the MP Capital Account. GRE has caused SRE to deliver to MP a statement of the estimated MP Capital Account, which estimate was determined on a basis consistent with the methodology to be employed in the calculation of the Capital Account of MP pursuant to Section 3.01(c) below (such estimate, the "**Estimated Execution Date MP Capital Account**"). GRE and MP agree that the Estimated Execution Date MP Capital Account amount is $12,406,996. On the Execution Date, GRE shall cause SRE to remit $10 million to MP as a partial distribution from the Capital Account of MP (the "**Execution Date MP Capital Account Distribution**").

(b) Execution Date MP Capital Account and Retained MP Capital Account. Subsequent to the Execution Date, the Estimated Execution Date MP Capital Account shall be reconciled to the actual balance of the Capital Account of MP (the "**Execution Date MP Capital Account**") in accordance with Section 3.02 below. The difference between the Execution Date MP Capital Account and the sum of: (x) $10 million

Execution Date MP Capital Account Distribution, and (y) the Membership Interest Payment (less the Capital Vig thereon) (such difference, the "**Retained MP Capital Account**") will be remitted to MP at the Closing, along with interest at an annual rate of 1.25% thereon from the Execution Date through the Closing Date (the "**Capital Vig**"), pursuant to receipt of the FERC Order (defined in Section 6.05(ii)). The parties acknowledge and agree that, at and upon the Closing, $1 million of the Capital Account of MP, representing the initial capital contribution of MP in SRE, shall be (1) retained in SRE, and (2) will become part of the GRE Capital Account in SRE.

(c) Computations for MP Capital Account. For purposes of computing (i) the Estimated Execution Date MP Capital Account, and (ii) the Execution Date MP Capital Account, each such capital account shall be determined in accordance with the book value of such MP Capital Account (as opposed to the Tax basis Capital Account of MP) determined in accordance with the generally accepted accounting principles of SRE consistently applied, except that MP and GRE have agreed to amend hereby such controlling provisions of the Member Control Agreement in order to incorporate the following deviations from prior practice. In furtherance of the foregoing, GRE shall cause SRE to adopt and incorporate the following accounting/allocation principles into the SRE accounting for its operations and its Capital Accounts for the period(s) commencing November 1, 2003 through the Execution Date:

(i) All trading gross margin (gross margin or gross loss from marketing activities) as determined in accordance with generally accepted accounting principles consistently applied by SRE arising from or incident to Power Trading Transactions (i) initiated on or after November 1, 2003, and (ii) those initiated prior to and delivered on or after November 1, 2003, in each case through the Execution Date, shall be allocated in their entirety (100%) to GRE and no allocation shall be made to MP; and

(ii) All core gross margin (gross margin from marketing activities) as determined in accordance with generally accepted accounting principles consistently applied by SRE arising from or incident to Core Operations prior to and through the Execution Date shall be allocated equally (50%/50%) to MP and GRE; and

(iii) The operating expenses and costs arising from or incident to Core Operations and Power Trading Transactions for the period (A) commencing November 1, 2003, through December 31, 2003, shall be allocated equally (50%/50%) to MP and GRE, except that MAPP and MAIN fees shall be allocated in accordance with historical practices, and (B) commencing January 1, 2004, to the Execution Date, the allocation of such operating expenses and costs shall be wholly (100%) to GRE, and no allocation shall be made to MP, except that (i) MAPP and MAIN fees shall be allocated in accordance with historical practices, and (ii) Three Hundred Twenty Five Thousand ($325,000) shall be allocated to MP for payment of Core Operations expenses for January, 2004; and

(iv) All credit facility fees and interest expense and gains/losses on foreign currency allocations relating to Power Trading Transactions for the period commencing November 1, 2003, through the Execution Date shall be allocated in their entirety (100%) to GRE and no allocation shall be made to MP; and

(v) All interest income for the period commencing November 1, 2003, through the Execution Date shall be allocated equally (50%/50%) to MP and GRE; and

(vi) Any adjustments, mark-to-market adjustments, and normal accounting adjustments made in the ordinary course of business shall be allocated (A) equally (50%/50%) to MP and GRE if such adjustment relates to the period prior to November 1, 2003, or (B) consistent with Sections 3.01(c) (i)-(v) of this Agreement if such adjustment relates to the period from and after November 1, 2003 through the Execution Date; and

(vii) In computation of any of the foregoing, or the MP Capital Account generally, all SRE Management Employee and non-Management Employee severance pay or other such termination costs (including non-cash benefits) shall be allocated in their entirety (100%) to GRE and no allocation shall be made to MP.

3.02 **MP Capital Account Reconciliation**.

(a) Statement of Execution Date MP Capital Account. As soon as practicable, and in no event later than twenty (20) days after the Execution Date, GRE shall cause SRE to prepare and provide to MP a final calculation of the Execution Date MP Capital Account determined as of the Execution Date (the "**Statement of Execution Date MP Capital Account**"), which Statement of Execution Date MP Capital Account shall be prepared in accordance with generally accepted accounting principles and procedures of SRE consistently applied, except for the adjustments required by Section 3.01(c) above. The reasonable fees, costs and expenses of Third Party professionals (but not the internal costs to SRE or GRE) associated with the preparation of the Statement of Execution Date MP Capital Account shall be borne one hundred percent (100%) by MP. MP shall have concurrent access to any of the work papers and source documentation of SRE or its professionals that are utilized in any way in the compilation of data or preparation of the Statement of Execution Date MP Capital Account. Within ten (10) days after its receipt of the Statement of Execution Date MP Capital Account, MP shall provide SRE with notice of any disagreement with the preparation of or the calculations underlying the Statement of Execution Date MP Capital Account, specifying in reasonable detail such disagreement. If within such ten (10) day period MP makes no objection to the Statement of Execution Date MP Capital Account, then the Statement of Execution Date MP Capital Account shall become final and binding upon the parties and the amount therein shall state the Execution Date MP Capital Account.

(b) Dispute Resolution. If MP objects to the Statement of Execution Date MP Capital Account in any manner, then GRE and MP shall negotiate in good faith for a

period of ten (10) days from and after the date of the MP objection(s) to resolve such objection(s). If the parties fail to agree on a Statement of Execution Date MP Capital Account within the aforementioned ten (10) day period, then, as to any matters still in dispute, MP and GRE shall refer the matter to arbitration conducted by a mutually acceptable accounting firm independent of GRE and MP (such firm to serve as arbitrator (the "**Accounting Arbitrator**") for the sole purpose of this Section 3.02(b)). The Accounting Arbitrator so selected will consider only those items and amounts set forth in the Statement of Execution Date MP Capital Account as to which MP and GRE have disagreed within the time periods and on the terms specified above and must resolve the matter in accordance with the terms and provisions of this Agreement. In submitting a dispute to the Accounting Arbitrator, each of MP and GRE shall concurrently furnish, at their own respective expense, to the Accounting Arbitrator and the other party such documents and information as the Accounting Arbitrator may request. Each party may also furnish to the Accounting Arbitrator such other information and documents as it deems relevant, with copies of such submission and all such documents and information being concurrently given to the other party. Neither party shall have or conduct any communication, either written or oral, with the Accounting Arbitrator without the other party, respectively, either being present or receiving a concurrent copy of any written communication. The Accounting Arbitrator may conduct a conference concerning the objections and disagreements between MP and GRE, at which conference each party shall have the right to (i) present its documents, materials and other evidence (previously provided to the Accounting Arbitrator and the other party), and (ii) have present its or their advisors, accountants, counsel and other representatives. The Accounting Arbitrator shall resolve each item of disagreement based solely on the presentations and supporting material provided by the parties and not pursuant to any independent review (the foregoing, however, shall not preclude the Accounting Arbitrator from independent research of facts or determining proper application of SRE generally accepted accounting principles consistently applied or the terms of this Agreement and the Ancillary Documents with respect to the subject matter of the objections and disagreement between the parties). The Accounting Arbitrator shall issue a detailed written report that sets forth the resolution of all items in dispute and that contains, as applicable, a final Statement of Execution Date MP Capital Account according to the dispute(s) noticed. Such report shall state the Execution Date MP Capital Account and be final and binding upon MP and GRE. The Accounting Arbitrator may choose to circulate a preliminary report(s) for the comment of the parties. The fees and expenses of the Accounting Arbitrator incurred in connection with the determination of the disputed items by the Accounting Arbitrator shall be borne equally by MP and GRE. MP and GRE shall, and GRE shall cause SRE to, cooperate fully with the Accounting Arbitrator and respond on a timely basis to all requests for information or access to documents or personnel made by the Accounting Arbitrator or by MP, all with the intent to fairly and in good faith resolve all disputes relating to the Statement of Execution Date MP Capital Account as promptly as reasonably practicable.

CONFIDENTIAL TREATMENT

ARTICLE 4

EMPLOYEES

4.01 **[*]**

4.02 **[*]**

4.03 **[*]**

4.04 **[*]**

*** TEXT HAS BEEN OMITTED PURSUANT TO A REQUEST FOR CONFIDENTIAL TREATMENT AND HAS BEEN FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION.**

ARTICLE 5

OPERATION OF SRE PRIOR TO CLOSING

For the period from November 1, 2003 through the dates indicated below, the parties agree to operate SRE as set forth in this Article 5.

5.01 **MP Credit Support of SRE**. MP credit support of SRE cannot be used for (i) Trading Operations transactions initiated after October 31, 2003, where delivery occurs after the Execution Date, nor (ii) for Core Operations transactions initiated after the Execution Date. MP will continue to maintain existing credit support and provide new credit support, on the same basis as MP has provided credit support in the past, until the Execution Date unless otherwise agreed by the parties and SRE. As set forth on **Schedule 5.01**, MP's credit support consists of guarantees to Third Parties and support of SRE's existing Co-Bank Credit Facility. MP's credit exposure continues through the cash settlement of all transactions for which it has provided credit support. MP and GRE have taken all steps necessary to assure that the Co-Bank Credit Facility will remain in place until June 30, 2004, although the guaranty of MP has been released.

5.02 **Risk Management**. Until the Execution Date, SRE will conduct its Business within the risk limits established by the SRE board resolution of November 12, 2003, which includes a $2.5 million for stress limit, and within the $5.0 million stop-loss limit, and any

additional policies as described in the SRE board minutes dated September 24, 2003, each as set forth in **Schedule 5.02**.

5.03 **Generation Availability Credit ("GAC") and Combustion Turbine Use ("CTU")**. GAC shall be settled with no payment to either party for all periods ending October 31, 2003. SRE shall not use or apply the GAC from the time November 1, 2003 through Closing. The methodology developed to determine CTU during the month of October, 2003, as shown in **Schedule 5.03,** will also be used to determine CTU for the Interim Period. GRE shall continue to promptly notify MP of the CTU amount on the first day of the next month and MP shall promptly pay the CTU amount.

ARTICLE 6

CONCURRENT EXECUTION DATE AND CLOSING DATE AGREEMENTS AND COOPERATION

6.01 **Execution Date and Closing Date Agreements**. On the Execution Date MP and GRE shall enter into the Core Consulting Services Agreement substantially in the form of **Exhibit D** hereto, whereby GRE shall provide transitional consulting services to MP. Promptly following the Closing, MP shall, and GRE shall cause SRE to, enter into the Support Services Agreement substantially in the form of **Exhibit E** hereto, whereby MP shall provide transitional services to SRE, which shall terminate the existing administrative services agreement between MP and SRE, the invoiced costs of which shall not exceed $25,000 per month beginning February 1, 2004.

6.02 **Cooperation on Certain Operational Matters.** The parties have reached an understanding and agreement with respect to the matters set forth in **Schedules 6.02 (a)-(e)**, as described below, as set forth in each such schedule.

Schedule 6.02(a)	Operational Matters: for International Falls, GENSYS and SMMPA, and Least Cost Supply
Schedule 6.02(b)	Joint Reporting
Schedule 6.02(c)	Mutual Generator Outage Protection
Schedule 6.02(d)	Kendall Brokering Agreement
Schedule 6.02(e)	Ancillary Agreements
Schedule 6.02(f)	MP-GRE Capacity Reservation and Option Agreements

6.03 **Transmission Matters.** MP and GRE agree that the current transmission positions and requests now held by SRE will be (i) retained by SRE, (ii) immediately assigned to MP, (iii) immediately assigned to RREC, or (iv) remain conditionally with SRE with some future predetermined disposition, as listed and described in **Schedule 6.03**. The contracts to effectuate these transmission assignments are attached in **Exhibit F** and GRE shall cause SRE to execute these contracts on the Execution Date and promptly file with MISO and any regulatory agencies, as may be required. In the event that the FERC Order is not issued, MP shall cause the transmission assignments to be reassigned to SRE.

6.04 **Transfer of Data**. MP and GRE shall, promptly following the Execution Date, effectuate the transfer to SRE of all copies of data used in the Business that is in MP's control including, but not limited to, data contained in MP's data warehouse or MP shall retain such data pending future transfer at SRE's request, subject to the data retention policy set forth in **Schedule 6.04**. Pending such transfer of data, the parties shall mutually cooperate to provide SRE with the same access to the data it had in the ordinary course of business prior to Closing.

6.05 **FERC Filing and Approval Order**. Promptly following the Execution Date, MP shall prepare and submit a statutory filing to FERC (the "**FERC Filing**") which seeks authority from FERC to relinquish MP's Membership Interest to GRE in accordance with Section 203 of the Federal Power Act, 16 U.S.C. 824(b) (alternatively, the "**Membership Interest Transfer Order**" or the "**FERC Order**").

In the event that either MP or GRE become aware that the Membership Initial Transfer Order may be, or is, the subject of an objection and therefore may result in a petition for rehearing, the parties shall determine whether or not to proceed with or delay the Closing pending resolution of the objection and/or rehearing, as the case may be. GRE agrees to support such filings at FERC and further agrees to cooperate with MP in providing any information regarding SRE and GRE in such proceedings.

6.06 **MP Exclusive Purchases and Sales**. From and after the Execution Date, MP and GRE agree that (i) MP shall assume all obligations and liability for least cost supply to serve its own native load customers, including but not limited to, purchase of capacity and energy from Third Parties and sale of excess MP generation resources not needed to serve the native load of MP, (ii) SRE shall have no obligation or liability for Core Operations with respect to MP, (iii) MP waives its rights under the Member Control Agreement for any and all allocations of gains or losses of SRE arising from Core Operations of SRE and MP shall have no further liability for any expenses of SRE Core Operations, and (iv) each shall immediately cause SRE to designate all MP purchases and sales of capacity and energy as "Exclusive Purchase and Sales" as defined in the SRE Rate Schedule No. 4 effective September 12, 2001 on file at FERC.

Nothing in this section shall alter any pre-existing MP obligation to SRE to fulfill any pre-existing SRE obligations to Third Parties for capacity or energy, including but not limited to, the GENSYS and SMMPA transactions as indicated in **Schedule 6.02(a)**.

ARTICLE 7

INDEMNIFICATION

7.01 **Indemnification by MP of GRE**. MP hereby covenants and agrees to defend, indemnify and hold harmless GRE and SRE, and their respective members, officers, directors, employees, affiliates, agents, successors and assigns (collectively, the "**Associated Indemnified Parties**"), from and against and in respect of any and all losses, costs, expenses (including reasonable attorneys' fees and disbursements of counsel), liabilities, damages, fines, penalties, charges, assessments, judgments, settlements, claims, causes of action, and other obligations of any nature whatsoever (excluding, however, claims for incidental, consequential, or special damages, including punitive damages, other than which arise from a Third Party claim against

the indemnified party hereunder) (individually, a "**Loss**," and collectively, "**Losses**") that GRE, SRE or their Associated Indemnified Parties may suffer, sustain, incur or be subject to arising out of, based upon or resulting from or on account of any of the following:

(a) the breach or falsity of any representation or warranty made by MP in this Agreement, the Interim Agreement or the Ancillary Documents; and

(b) the breach of any covenant or agreement made by MP in this Agreement, the Interim Agreement and/or the Ancillary Documents (although the pre-Closing covenants to obtain all Consents shall expire upon the Closing); and

(c) one-half (1/2) of expenses of SRE (net of any Tax benefit by way of deduction or deferral and insurance recoveries), which arise from any period prior to the Execution Date, which are (i) not accounted for in the computation of the Execution Date MP Capital Account as finally determined, and (ii) not excluded in a category of expenses in the reconciliation of the MP Capital Account pursuant to the provisions of Section 3.01(c) of this Agreement; and

(d) one-half (1/2) of any Losses (excluding severance pay or other such termination costs made to a non-Management Employee of SRE) arising out of any claim(s) arising from, in connection with or incident to the termination of the employment of any SRE employee to the extent attributable to downsizing or restructuring of SRE as a consequence of the withdrawal of MP from SRE where such termination occurs during the period from and after the Execution Date through October 31, 2004; and

(e) the reasonable attorneys fees and expenses incurred by GRE and SRE from and after January 23, 2004 through the Closing Date or the date this Agreement is terminated, whichever date occurs earlier, arising from and in connection with the requirement of the FERC Filing described in Section 6.05 hereof (the "**GRE Attorney Fees**"). All such GRE Attorney Fees shall be paid by MP within fifteen (15) days of presentment by GRE.

7.02 **Indemnification by GRE of MP**. GRE hereby covenants and agrees to defend, indemnify and hold harmless MP, and its Associated Indemnified Parties, from and against any Loss and all Losses that MP or its Associated Indemnified Parties may suffer, sustain, incur, or be subject to arising out of, based upon or resulting from or on account of any of the following:

(a) the breach or falsity of any representation or warranty made by GRE in this Agreement, the Interim Agreement or any Ancillary Document; and

(b) the breach of any covenant or agreement made by GRE, or by GRE on behalf of SRE, in this Agreement, the Interim Agreement, and/or any Ancillary Document; and

(c) any SRE Losses, as defined in the Interim Agreement, which arise from, in connection with or incident to (i) SRE Trading Operations, including market or credit exposure, (ii) MP credit support of the Trading Operations, including (x) any MP

guaranty providing credit support to SRE's Trading Operations, or (y) any letters of credit issued to provide credit support to SRE's Trading Operations under the CoBank Credit Facility, and (iii) cash collateral posted by SRE to support Trading Operations, including but not limited to Five Million Dollars ($5,000,000) posted by SRE in deposit with American Electric Power on or about December 23, 2003, and any such cash posted for deposit by SRE will not impact the distribution of cash to MP or MP's Capital Account; and

(d) any claim(s) arising from, in connection with or incident to any lease of premises to which SRE is a party or MP's guaranty thereof; and

(e) any claim(s) arising from, in connection with or incident to the operations or contracts of SRE or GRE (with respect to SRE) after the Execution Date, except (i) for Power Trading Transactions that were initiated prior to November 1, 2003, but which are not settled until after the Execution Date, and (ii) to the extent of the indemnification obligation of MP described in Section 7.01(d) of this Agreement.

7.03 **Principles Regulating Indemnity Rights**.

(a) Without limiting the generality of the foregoing, with respect to any measurement of damages or costs or expenses owing hereunder, either party shall have the right to be put in the same financial position as it would have been had the matter leading to the claim of indemnification never occurred or arose. Each party shall be reimbursed by the other on a monthly basis for all liabilities and damages incurred and all reasonable costs and reasonable expenses incurred in enforcing this indemnity.

(b) Notwithstanding any other provision herein, either party shall be entitled to seek equitable relief with respect to any indemnification claim which arises from a covenant hereof. Each party shall use reasonable efforts to provide prompt notice to the other of each indemnifiable claim it believes it has suffered; provided, however, no delay in providing any such notice shall affect its right to recover damages or equitable relief as appropriate under this Agreement. The foregoing covenant shall be for the benefit of the parties hereto and shall not be deemed to give any Third Party rights under this Agreement.

(c) The parties understand and agree that GRE shall prevent SRE from asserting any claim of any kind against MP and its affiliates arising from, in connection with or incident to any action or omission of MP or its affiliates prior to the Closing Date, as a consequence of the occurrence of the Closing.

7.04 **Procedure for Indemnification**.

(a) MP Direct Indemnification of GRE. In the event that GRE and/or any of its Associated Indemnified Parties (individually, a "**GRE Indemnified Party**" and collectively, the "**GRE Indemnified Parties**") intends to seek indemnification under this Agreement pursuant to the provisions of Sections 7.01 of this Agreement, the GRE Indemnified Party shall promptly give notice hereunder to MP, specifying in such notice, to the extent such specific information is available, (i) the specific nature of the Loss or

Losses to be indemnified, (ii) the amount and, as applicable, a computation of the amount, of such Loss or Losses, (iii) any and all evidence of such Loss or Losses, including all documents, instruments, notices and financial data, in whatever form or media, sufficient for MP to ascertain the propriety and amount of the indemnification claim, and (iv) any relevant dates relating to the assertion, accrual and payment of the Loss or Losses (collectively, the "**Required Notice Information**"). MP shall have ten (10) days to consider such claim and, within such period shall either (x) object by written notice to the GRE Indemnified Party to the claim, in whole or in part, or (y) remit the undisputed amount requested by the GRE Indemnified Party. In the event that the claim is objected to by MP in whole or in part, the parties shall attempt to resolve the dispute within ten (10) business days of the receipt of the MP objection by the GRE Indemnified Party. In the event the parties are unable to resolve the disputed claim within such period, the matter shall be resolved pursuant to the arbitration procedure set forth in Section 7.04(e) hereof.

(b) GRE Direct Indemnification of MP. In the event that MP and/or any of its Associated Indemnified Parties (individually, an "**MP Indemnified Party**" and collectively, the "**MP Indemnified Parties**") intends to seek indemnification under this Agreement pursuant to the provisions of Section 7.02 of this Agreement, the MP Indemnified Party shall promptly give notice hereunder to GRE, specifying in such notice the Required Notice Information, to the extent such specific information is available. GRE shall have ten (10) days to consider such claim and, within such period, shall either (x) object by written notice to the MP Indemnified Party to the claim, in whole or in part, or (y) remit the undisputed amount requested by the MP Indemnified Party. In the event that the claim is objected to by GRE in whole or in part, the parties shall attempt to resolve the dispute within ten (10) business days of the receipt of the GRE objection by the MP Indemnified Party. In the event the parties are unable to resolve the disputed claim within such period, the matter shall be resolved pursuant to the arbitration procedure set forth in Section 7.04(e) hereof.

(c) Procedure for Indemnification of Third Party Claims. In the event any of the GRE Indemnified Parties or the MP Indemnified Parties intend to seek indemnification pursuant to the provisions of Sections 7.01 or 7.02 hereof as a result of the claim of a Third Party (the "**Indemnified Party**"), the Indemnified Party shall promptly give notice hereunder to the other party (the "**Indemnifying Party**") after obtaining written notice of any service of a summons or notice of a Proceeding in any action instituted against the Indemnified Party as to which recovery or other action may be sought against the Indemnified Party because of the indemnification provided for in Sections 7.01 or 7.02 hereof, and the Indemnified Party shall permit the Indemnifying Party to assume the defense of any such Proceeding; provided, however, that the Indemnified Party shall not be required to permit such an assumption of the defense of any Proceeding which, if not first paid, discharged or otherwise complied with, would result in a material interruption or disruption of the business of the Indemnified Party, or any material part thereof. Notwithstanding the foregoing, the right to indemnification hereunder shall not be affected by any failure of the Indemnified Party to give such notice (or by delay by the Indemnified Party in giving such notice) unless, and then only to the

extent that, the rights and remedies of the Indemnifying Party shall have been prejudiced as a result of the failure to give, or delay in giving, such notice.

If the Indemnifying Party assumes the defense of such Proceeding referenced in the Indemnified Party's notice, the obligations of the Indemnifying Party hereunder as to such Proceeding shall include taking all steps necessary in the defense or settlement of such Proceeding and holding the Indemnified Party harmless from and against any and all Losses arising from, in connection with or incident to any settlement approved by the Indemnifying Party or any judgment entered in connection with such Proceeding, except where, and only to the extent that, the Indemnifying Party has been prejudiced by the actions or omissions of the Indemnified Party. Notwithstanding the foregoing, the assumption of the defense of any Proceeding by the Indemnifying Party shall not constitute an admission of responsibility to indemnify or in any manner impair or restrict the Indemnifying Party's rights to later seek to be reimbursed its costs and expenses if indemnification under this Agreement with respect to such Proceeding was not required. The Indemnifying Party shall not, in the defense of such Proceeding, consent to entry of any judgment (other than a judgment of dismissal on the merits without costs) except with the written consent of the Indemnified Party (which consent shall not be unreasonably withheld, delayed or conditioned) or enter into any settlement (except with the written consent of the Indemnified Party, which consent shall not be unreasonably withheld, delayed or conditioned) unless (i) there is no finding or admission of any violation of applicable law and no material effect on any claims that could reasonably be expected to be made against the Indemnified Party, (ii) the sole relief provided is monetary damages, and (iii) the settlement shall include the giving by the claimant or the plaintiff to the Indemnified Party a release from all liability in respect to such claim or litigation.

If the Indemnifying Party assumes the defense of such Proceeding referenced in the Indemnified Party's notice, the Indemnified Party shall be entitled to participate in the defense of the claim. The Indemnified Party shall bear the fees and expenses of any additional counsel retained by it to participate in its defense unless any of the following shall apply: (i) the employment of such counsel shall have been authorized in writing by the Indemnifying Party, or (ii) the Indemnifying Party's legal counsel shall advise the Indemnifying Party in writing, with a copy to the Indemnified Party, that there is a conflict of interest that would make it inappropriate under applicable standards of professional conduct to have common counsel. If clause (i) or (ii) in the immediately preceding sentence is applicable, then the Indemnified Party may employ separate counsel at the expense of the Indemnifying Party to represent the Indemnified Party, but in no event shall the Indemnifying Party be obligated to pay the costs and expenses of more than one such separate counsel for any one complaint, claim, action or Proceeding in any one jurisdiction.

If the Indemnifying Party does not assume the defense of any such Proceeding by a Third Party after receipt of notice from the Indemnified Party, the Indemnified Party may defend against such Proceeding in such manner as it reasonably deems appropriate. The Indemnified Party may not settle such claim or litigation without the written consent of the Indemnifying Party, which consent shall not be unreasonably withheld.

Each party shall cooperate in good faith and in all respects with each Indemnifying Party and its representatives (including without limitation its counsel) in the investigation, negotiation, settlement, trial and/or defense of any Proceedings (and any appeal arising therefrom). The parties shall cooperate with each other in any notifications to and information requests of any insurers. No individual representative of any party, or their respective affiliates, shall be personally liable for any Loss or Losses under this Agreement, except as specifically agreed to by said individual representative.

(d) Remedies. The respective indemnification obligations of the parties set forth in Article 7 of this Agreement are the exclusive remedies of the parties and their successors, assigns or others seeking to claim by, through, or on behalf of a party, under this Agreement, and no other remedy or remedies, whether arising under any applicable law, common law or otherwise, may be used, asserted or prosecuted in connection with this Agreement and any transaction, occurrence, or omission arising from, in connection with or otherwise based upon this Agreement; provided, however, that all equitable remedies shall remain available other than rescission, which shall not be an available remedy of either party hereto, or their respective successors and assigns, under or pursuant to this Agreement. This Section 7.04(d) shall not be applicable in the specific instances in which a party hereto has committed fraud.

7.05 **Dispute Resolution**. In the event a dispute arises under this Agreement, except with respect to Article 3 or equitable remedies pursued under this Agreement, such disputes shall be resolved in the manner set forth in this Section 7.05.

(a) If a dispute arises under this Agreement, including any question regarding the existence, validity, interpretation or termination hereof, which is not described as an exception in this Section 7.05, GRE and MP may invoke the dispute resolution procedure set forth in this Section 7.05 by giving written notice to the other party. If either party gives such a notice, the parties shall enter into discussions concerning this dispute. If the dispute is not resolved as a result of such discussion in ten (10) days, an attempt will be made to resolve the matter by a formal nonbinding mediation with an independent neutral mediator agreed to by the parties. If the parties cannot agree on a mediator within a period of ten (10) days after expiration of the ten (10) day period for resolution by discussion, then either party may apply to any court of competent jurisdiction for appointment of a mediator, which appointment shall be binding and nonappealable. Upon commencement of the mediation process, the parties shall promptly communicate with respect to a procedure and schedule for the conduct of the Proceeding and for the exchange of documents and other information related to the dispute. The mediation process shall be deemed ended if the dispute has not been resolved within thirty (30) days after appointment of the mediator.

(b) All claims, disputes or other matters in question between the parties to this Agreement arising out of or relating to this Agreement which are not resolved by mediation in accordance with Section 7.05(a) within thirty (30) days after appointment of mediator shall be submitted for, subject to and decided by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association currently in effect as of the date of this Agreement ("**AAA Rules**"), except to the extent those rules

are inconsistent with this Section 7.05. Any arbitration must be held in Minnesota by a single arbitrator mutually selected by the parties hereto or, if the parties hereto cannot agree on the appointment of such arbitrator within ten (10) days following the date notice of the dispute is given by a party to the adverse party, an arbitrator selected according to the AAA Rules. The arbitrator's award shall be final, conclusive and binding upon all parties to this Agreement, and judgment may be entered upon it in accordance with the Federal Arbitration Act in any court described in Section 7.05(c). The arbitrator shall be required to provide in writing to the parties the basis for the award or Order of such arbitrator, and a court reporter shall record all hearings (unless otherwise agreed to by the parties), with such record constituting the official transcript of such Proceedings. MP and GRE specifically desire this Arbitration clause to be governed by the United States Federal Arbitration Act, and not by the arbitration laws of any state.

(c) MP and GRE agree and consent that any legal action, suit or Proceeding seeking to enforce this Section 7.05 or to confirm or contest any arbitration award shall be instituted and adjudicated solely and exclusively in any court of general jurisdiction in Minnesota, or in the United States District Court having jurisdiction in Minnesota and MP and GRE agree that venue will be proper in such courts and waive any objection which they may have now or hereafter to the venue of any such suit, action or Proceeding in such courts, and irrevocably consent and agree to the jurisdiction of said courts in any such suit, action or Proceeding. MP and GRE further agree to accept and acknowledge service of any and all process which may be served in any such suit, action or Proceeding in said courts, and also agree that service of process or notice upon them shall be deemed in every respect effective service of process or notice upon them, in any suit, action or Proceeding, if given or made: (i) by a Person over the age of eighteen who personally serves such notice or service of process on MP or GRE, as the case may be, or (ii) by certified mail, return receipt requested, mailed to MP or GRE, as the case may be, at their respective addresses set forth in this Agreement.

(d) In the event of arbitration filed or instituted between the parties pursuant to this Section 7.05, the prevailing party will be entitled to receive from the adverse party all costs, damages and expenses, including reasonable attorney's fees, incurred by the prevailing party in connection with that action or Proceeding, whether or not the controversy is reduced to judgment or award. The prevailing party will be that party who is determined by the arbitrator to have prevailed on the major disputed issues.

ARTICLE 8

ADDITIONAL AGREEMENTS WITH RESPECT TO OPERATION OF SRE PRIOR TO CLOSING

8.01 **Actions Refrained From Prior to Closing**. Between the Effective Date and the Closing Date, GRE and MP shall cause SRE not do any of the following without prior written authorization from MP and GRE:

(a) merge or consolidate with or into any other entity or enter into any agreements relating thereto; or

(b) authorize or make any distribution of capital or property to any Member of SRE other than as contemplated by this Agreement and, with respect to the Retained MP Capital Account, pursuant to the FERC Order.

8.02 **Affirmative Actions Prior to Closing**. Between the Effective Date and the Closing Date, except as otherwise consented to in writing by MP and GRE, GRE and MP shall cause SRE to:

(a) continue to make available to MP and GRE and its counsel, accountants and other representatives for examination all business and financial books and records of SRE, as well as all other information reasonably considered relevant to the Business and affairs of SRE;

(b) operate the Business in accordance with the MPUC Order dated June 1, 2000, and consistent with that operation SRE shall use all commercially reasonable efforts to preserve intact SRE's present business organization and goodwill of customers, suppliers and others having business relations with SRE, and maintain SRE's membership and joint reporting in MAPP.

(c) maintain SRE's books of account, records and files substantially in the same manner as they are maintained as of the date of, but giving effect to the provisions of, this Agreement and make no change in accounting principles utilized presently;

(d) maintain and enforce existing policies of insurance or substitute policies providing reasonably comparable insurance coverage in amounts not less than those in effect on the date of this Agreement and in any event in amounts of coverage which are at least typical for companies of SRE's size and in SRE's industry; and

(e) take all required corporate action to effectuate and perform the transactions contemplated by this Agreement and use commercially reasonable efforts to satisfy the conditions to the obligations to close the transactions contemplated herein, to the extent such conditions are within the reasonable control of SRE.

ARTICLE 9

REPRESENTATIONS AND WARRANTIES OF MP

MP represents and warrants to GRE that:

9.01 **Corporate Standing and Authority; Binding Agreement**. MP is a division of ALLETE, Inc., a corporation duly organized, validly existing and in good standing under the laws of the State of Minnesota and has full corporate power to own all of its properties and assets and to conduct its business as it is now being conducted. The execution of this Agreement and consummation of the transactions contemplated herein shall not violate any provision of MP's Articles of Incorporation or Bylaws, and MP has obtained all necessary corporate authorization for the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby. This Agreement is a legal, valid and binding agreement of MP, enforceable against MP in accordance with its terms, subject to the laws of bankruptcy,

insolvency and moratorium and other laws or equitable principles generally affecting creditors' rights.

9.02 **Absence of Conflicting Agreements or Required Consents**. Except (x) for submitting the FERC Filing described in Section 6.05 and obtaining the FERC Order, and (y) as set forth in **Schedule 9.02**, the execution, delivery and performance of this Agreement by MP, including, without limitation, the assignment of its Membership Interests to GRE, does not and will not: (i) conflict with or violate any law, rule, regulation, Order, judgment or decree applicable to MP or by which any of MP's assets are bound or affected, (ii) result in any breach of or constitute a default under any contract or other agreement or note, bond, mortgage, indenture, lease, license, franchise or other instrument or obligation to which MP is a party or by which any of the MP assets are bound or affected, or (iii) require any consent, approval, authorization or permit of any governmental or regulatory authority, domestic or foreign, or any person or entity not a party to this Agreement ("**Consents**").

9.03 **Title**. As of the Execution Date (i) MP shall have good and marketable title to the Assets that are Tangible Assets, such title to be free and clear of all liens, claims, security interests, mortgages, easements, restrictions, charges and encumbrances (other than those in favor of GRE under the Member Control Agreement), and (ii) with respect to the Assets that are leased or licensed, MP shall have a valid license or leasehold interest. As of the Closing, MP shall have good and marketable title to its Membership Interest.

9.04 **Relinquished Assets**. MP has title to or a valid leasehold or license interest to the Assets. The Assets relinquished and transferred by MP are in operating condition and are as is, where is, as used at and by SRE in the normal course of business. The Assets are all of the Assets used exclusively in the Business, but shall not include assets used in the Business which are also used in the operation of the business of MP (by way of example, the Oracle accounting system software).

9.05 **Litigation**. There is no litigation pending or, to the best knowledge of MP after due inquiry of its officers, threatened against MP which seeks to prevent, or if successful would prevent, MP from consummating the purchase contemplated by this Agreement.

9.06 **Notice of Development**. MP shall notify GRE of any event or occurrence that has as its basis an event or occurrence that arose after the date hereof which would cause a breach at the Closing of any of the representations and warranties set forth in Sections 9.01, 9.02 and 9.05.

ARTICLE 10

REPRESENTATIONS AND WARRANTIES OF GRE

GRE represents and warrants to MP that:

10.01 **Organization and Authority**. GRE is a cooperative duly organized, validly existing and in good standing under the laws of the State of Minnesota, and has full power and authority to carry on its current business operations and consummate the transactions

contemplated by this Agreement. The execution of this Agreement and consummation of the transactions contemplated herein shall not violate any provision of GRE's governing documents or any law, regulation or ordinance or any provision of any contract, instrument, Order, award, judgment or decree to which GRE is a party or by which GRE is bound. This Agreement is a legal, valid and binding agreement of GRE enforceable against GRE in accordance with its terms, subject to the laws of bankruptcy, insolvency and moratorium and other laws or equitable principles generally affecting creditors' rights. GRE has obtained all necessary cooperative authorization and approval for the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby. No consent, authorization, Order or approval of any person, governmental authority or any court is required in connection with the execution and delivery by GRE of this Agreement or the consummation by GRE of the transactions contemplated hereby.

10.02 **Litigation**. There is no litigation pending or, to the best knowledge of GRE after due inquiry of its officers, threatened against GRE which seeks to prevent, or if successful would prevent, GRE from consummating the purchase contemplated by this Agreement.

10.03 **Notice of Development**. GRE shall notify MP of any event or occurrence that has as its basis an event or occurrence that arose after the date hereof which would cause a breach at the Closing of any of the representations and warranties set forth in Sections 10.01 and 10.02.

ARTICLE 11

CLOSING

11.01 **Time and Place**. Upon receipt of the Membership Interest Transfer Order which is not subject to an objection that may result in a rehearing by FERC (such that the parties have agreed to delay the Closing pursuant to Section 6.05 hereof), MP and GRE shall schedule the Closing, which shall take place not later than five (5) business days after receipt of the FERC Order (the "**Closing Date**"). The closing hereunder (the "**Closing**") shall take place at the offices of Leonard, Street and Deinard, Professional Association, 150 South Fifth Street, Suite 2300, Minneapolis, Minnesota, 55402, or at such other time and place as may be agreed to by the parties. The Closing shall be deemed to be effective at 11:59 P.M. (CST) on the Closing Date, which shall also be the Withdrawal Effective Time.

11.02 **Conditions to MP's Obligations to Close**. The obligation of MP to Close shall be subject to satisfaction of the following deliverables and conditions precedent on or prior to the Closing Date:

(a) Payments and Delivery of Documents:

(i) Receipt of Membership Interest Payment. MP shall receive the Membership Interest Payment from GRE at the Closing.

(ii) Receipt of the Retained MP Capital Account. MP shall receive payment from SRE at the Closing of the Retained MP Capital Account and the Capital Vig.

(iii) GRE Officer's Certificate. MP shall receive a certificate from an officer of GRE, in form and content reasonably satisfactory to MP, certifying (i) to the incumbency of GRE's authorized officers executing this Agreement and related documents, (ii) to the good standing of GRE in the state of its organization and attaching a good standing certificate for GRE issued by the Secretary of State of such state, (iii) that all necessary corporate authorizations and approvals have been obtained by GRE for the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereunder, and (iv) that the execution of this Agreement by GRE and the consummation of the transactions contemplated hereunder will not violate the provisions of the Articles of Incorporation of GRE or any other agreement to which GRE is a party or by which it is bound. A certificate in substantially the same form containing the above information has been delivered to MP on the Execution Date

(iv) Consent. The (A) FERC Order, and (B) the Consents set forth in **Schedule 9.02**, shall all have been obtained.

(b) Conditions Precedent to Closing:

(i) Representations, Warranties and Covenants. All covenants and agreements of GRE set forth herein required to be performed prior to the Closing shall have been fully performed and the representations and warranties of GRE set forth herein shall be true and correct as of the Closing Date as though those representations and warranties have been made at and as of that time. At the Closing, MP shall have received a certificate signed by a duly authorized officer of GRE to the foregoing effect in form and content reasonably satisfactory to MP.

(ii) No Litigation. There shall not have been instituted or threatened on or before the Closing Date any action or Proceeding to restrict or prohibit the transactions contemplated by this Agreement.

11.03 **Conditions to GRE's Obligation to Close**. The obligation of GRE to close shall be subject to satisfaction of the following deliverables and conditions precedent on or prior to the Closing Date or at and upon the Closing:

(a) Payments and Delivery of Documents:

(i) Payment of Unpaid Administrative Fee(s) and GRE Attorney Fees, Severance Reimbursement. GRE shall receive payment from MP of any unpaid Administrative Fee(s), unpaid severance reimbursement pursuant to Section 4.03, unpaid CTU payments and unpaid GRE Attorney Fees.

(ii) Membership Interest Relinquishment and Assignment. MP shall have duly executed and delivered to GRE, all in form and substance reasonably satisfactory to GRE, a Relinquishment and Assignment of Membership Interest in substantially the form attached hereto as **Exhibit C**.

(iii) Consents. The FERC Order shall have been obtained and any and all notices or Consents listed or required to be listed under **Schedule 11.03(a)(iii)** shall have been duly made by MP or executed and delivered by the person or entity required to consent, in form and content reasonably satisfactory to GRE, and shall have been delivered to GRE by MP.

(iv) MP Officer's Certificate. GRE shall have received a certificate from an officer of MP, in form and content reasonably satisfactory to GRE, certifying (i) to the incumbency of MP's authorized officers executing this Agreement and related documents, (ii) to the good standing of MP in the state of its incorporation and attaching a good standing certificate for MP issued by the Secretary of State of such state, (iii) that all necessary authorizations and approvals have been obtained by MP for the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereunder, and (iv) that the execution, delivery and performance of this Agreement by MP and the consummation of the transactions contemplated hereunder will not violate the provisions of MP's Articles of Incorporation or Bylaws or any other agreement to which MP is a party or by which it is bound. A certificate in substantially the same form containing the above information has been delivered to GRE on the Execution Date.

(v) Resignations. GRE shall have received the written resignations of any MP designated members of the SRE Board of Governors. MP personnel who were also SRE officers resigned as officers of SRE on the Execution Date.

(b) Conditions Precedent to Closing:

(i) Representations, Warranties and Covenants. All covenants and agreements of MP set forth herein required to be performed prior to the Closing shall have been fully performed and the representations and warranties of MP set forth herein shall be true and correct as of the Closing Date as though those representations and warranties had been made at and as of that time. At the Closing, GRE shall have received a certificate signed by a duly authorized officer of MP to the foregoing effect in form and content reasonably satisfactory to GRE.

(ii) No Litigation. There shall not have been instituted or threatened any action or Proceeding to restrict or prohibit the transactions contemplated by this Agreement.

11.04 **Efforts to Satisfy Conditions**. Each party shall use reasonable commercial efforts to secure promptly the satisfaction of the conditions to Closing, to the extent the same is within their reasonable control.

ARTICLE 12

TERMINATION

12.01 **Termination of Agreement**. This Agreement may be terminated at any time prior to the Closing:

(i) by mutual written agreement of GRE and MP; or

(ii) by either MP or GRE if, through no breach of this Agreement by the terminating party, the Closing has not occurred on or before May 31, 2004.

No termination of this Agreement shall (i) affect the transactions which become effective on or entered into as a consequence of, the Execution Date, which transactions shall be legal, binding and enforceable with respect to the parties thereto, or (ii) relieve any party from liability it may have under this Agreement or the Interim Agreement from breaches of its respective representations, warranties or covenants occurring prior to termination.

12.02 **Procedure Upon Termination**. In the event of termination by GRE or by MP pursuant to Section 12.01(ii) hereof, written notice thereof shall forthwith be given to the other party and the transactions contemplated by this Agreement to be effected at the Closing shall be terminated without further action by the parties hereto. If such a termination takes place:

(a) The Interim Agreement and the transactions that took effect on the Execution Date shall be unaffected;

(b) MP shall continue to be bound by the Member Control Agreement, subject to the amendments set forth herein;

(c) No party hereto and none of their respective directors, officers, shareholders or controlling persons shall have any liability or further obligation to any other party pursuant to this Agreement or the Interim Agreement, except as to any breach of the continuing covenants hereof; and

(d) The provisions of Articles 1, 2, 3, 4, 5, 7, 12 and 14 and Sections 6.02, 6.03, 6.04, 6.06, 9.01, 9.03, 9.04, 10.01, 13.01, 13.02 and 13.03 shall survive any termination of this Agreement; provided, however, Sections 12.02(a) and (c) above shall control and constitute the exclusive remedy of the parties with respect to any Losses that may be claimed by a party under this Agreement.

ARTICLE 13

OTHER MATTERS

13.01 **Announcements**. No press releases, announcements, or other disclosure related to the specific details of this Agreement or the transactions contemplated herein shall be issued or made to the press, employees, customers, suppliers or any other person, except to the extent necessary for MP or GRE to (i) comply with applicable securities or other regulatory laws, rules,

or regulations, or other applicable authority, or (ii) obtain MP's release from its credit support obligations, or (iii) as otherwise necessary to comply with the terms of this Agreement. GRE and MP agree to cooperate on any external communications regarding MP's withdrawal from SRE. The parties will cause SRE to observe this provision.

13.02 **Use of SRE Name**. As of the Closing Date and thereafter, MP shall cease all use of the name "Split Rock Energy" and any other similar names, except to the extent the name is used in connection with MP delivery of services on behalf of SRE or GRE as directed by SRE or GRE.

13.03 **Confidentiality**. The parties may, for their mutual benefit in the course of negotiating and implementing the transactions contemplated by this Agreement, exchange information which is of a non-public proprietary or confidential nature to the disclosing party which, by way of example but not limitation, may include information related to Core Operations, Power Trading Transactions, business practices, strategies or approaches, Capital Accounts, Net Income and Net Losses (the "**Confidential Information**"). The Confidential Information may be in any form whatsoever, including writings, computer programs, logic diagrams, drawings or other media. All information disclosed by either party to the other, whether orally, in writing by inspection or otherwise, shall be Confidential Information when it is so labeled or identified by the party delivering the information.

The Confidential Information (i) may be used by the receiving party solely in connection with the transactions described in this Agreement, and (ii) will be kept confidential and not disclosed by the receiving party to any other person, except that Confidential Information may be disclosed to (i) the United States Securities and Exchange Commission and any counterpart agency of any state, whether or not such Confidential Information shall be made publicly available as a consequence of such filing, and (ii) any of the receiving party's affiliates, directors, officers, employees, attorneys, accountants, consultants, advisors and agents (collectively, its "**Authorized Representatives**") who require access to such information and as required to comply with Section 13.04 below. Each of the Parties agrees that any of its Authorized Representatives to whom Confidential Information is disclosed will be informed of the confidential or proprietary nature thereof and of the receiving party's obligations under this Agreement, and that each party shall be responsible for any use or disclosure of Confidential Information by any of its Authorized Representatives.

Notwithstanding anything to the contrary set forth herein, Confidential Information shall not include any information that (i) is, on the Effective Date of this Agreement, available to the public (including in any publicly filed document), or (ii) becomes generally known to the public after the Effective Date of this Agreement other than as a result of any improper act or omission of MP or GRE or their Authorized Representatives, or (iii) was demonstrably known to MP or GRE prior to the Effective Date of this Agreement, or (iv) MP or GRE lawfully receive such Confidential Information from a Third Party, who is not subject to an obligation of confidentiality or non-use at the time of such transmittal.

If MP or GRE is requested or required (by oral questions, interrogatories, requests for information or documents, subpoena, civil investigative demand or similar process) to disclose any of the other party's Confidential Information, MP or GRE will provide the other party with

prompt notice of such request, and the documents and/or information requested thereby, so that the other party may seek an appropriate protective Order and/or waive compliance with the provisions of this Agreement. If, in the absence of a protective Order or the receipt of a waiver hereunder, MP or GRE are nonetheless, in the opinion of MP or GRE's legal counsel, compelled to disclose Confidential Information to any tribunal or otherwise stand liable for contempt or suffer other censure or penalty, MP or GRE may disclose to such tribunal, without liability hereunder, that portion of the Confidential Information which MP or GRE's legal counsel advises that MP or GRE are compelled to disclose; provided, however, that MP or GRE shall give the other party written notice of the information to be disclosed as far in advance of its disclosure as reasonably practicable.

13.04 **Tax Matters**. The following provisions shall govern the allocation of responsibility as between MP and the GRE for certain Tax Matters following the Closing Date:

(a) Tax Returns.

(i) MP shall prepare, execute on behalf of SRE and timely file, or cause to be prepared and timely filed, all income/reporting Tax Returns of SRE that are due with respect to any taxable year or other taxable period ending prior to or ending on and including the Closing Date. Such authority shall include, but not be limited to, the determination of the manner in which any items of income, gain, deduction, loss or credit arising out of the income, properties and operations of SRE shall be reported or disclosed in such Tax Returns; provided, however, that such Tax Returns shall be prepared by treating items on such Tax Returns in a manner consistent with the past practices with respect to such items, except for the allocation provisions of this Agreement which shall be an exception to such prior treatment.

(ii) Except as provided in Section 13.04(a)(i), GRE shall have the exclusive authority and obligation to prepare and timely file, or cause to be prepared and timely filed, all income/reporting Tax Returns of SRE with respect to any taxable year or other taxable period ending after the Closing Date; provided, however, with respect to Tax Returns to be filed by GRE pursuant to this Section 13.04(a) for taxable periods beginning before the Closing Date and ending after the Closing Date, items set forth on such Tax Returns shall be treated in a manner consistent with the past practices with respect to such items, except for the allocation provisions of this Agreement which shall be an exception to such prior treatment. Such authority shall include, but not be limited to, the determination of the manner in which any items of income, gain, deduction, loss or credit arising out of the income, properties and operations of SRE shall be reported or disclosed on such Tax Returns.

(b) Controversies. GRE shall promptly notify MP in writing upon receipt by GRE or SRE or any affiliate of GRE or SRE after the Closing Date) of written notice of any inquiries, claims, assessments, audits or similar events with respect to Taxes relating to a taxable period ending prior to or ending on and including the Closing Date for which SRE may be liable under this Agreement (any such inquiry, claim, assessment, audit or

similar event, a "**Tax Matter**"). MP, or its duly appointed representative (the "**MP Representative**"), at its sole expense, shall have the authority to represent the interests of SRE with respect to any Tax Matter before the Internal Revenue Service, any other taxing authority, any other governmental agency or authority or any court and shall have the sole right to control the defense, compromise or other resolution of any Tax Matter, including responding to inquiries, filing Tax Returns and contesting, defending against and resolving any assessment for additional Taxes or notice of Tax deficiency or other adjustment of Taxes of, or relating to, a Tax Matter; provided, however, that neither MP nor any of its affiliates shall enter into any settlement of or otherwise compromise any Tax Matter that affects or may affect the Tax liability of GRE or SRE for any period ending after the Closing Date, including the portion of a period beginning before the Closing Date and ending after the Closing Date (the "**Overlap Period**") that is after the Closing Date, without the prior written consent of GRE. The MP Representative shall keep GRE fully and timely informed with respect to the commencement, status and nature of any Tax Matter. The MP Representative shall, in good faith, allow GRE, at its sole expense, to make comments to the MP Representative, regarding the conduct of or positions taken in any such Proceeding.

Except as otherwise provided in this Section 13.04(b), GRE shall have the sole right to control any audit or examination by any taxing authority, initiate any claim for refund or amend any Tax Return, and contest, resolve and defend against any assessment for additional Taxes, notice of Tax deficiency or other adjustment of Taxes of, or relating to, the income, assets or operations of SRE for all taxable periods; provided, however, that GRE shall not, and shall cause its affiliates (including SRE) not to, enter into any settlement of any contest or otherwise compromise any issue with respect to the portion of the Overlap Period ending on or prior to the Closing Date without the prior written consent of MP, which consent shall not be unreasonably withheld.

(c) Amended Tax Returns. Neither MP nor SRE shall file or cause to be filed any amended Tax Return or claims for refund without the prior written consent of GRE, which consent shall not be unreasonably withheld, delayed or conditioned, except for such amended Tax Returns or claims for refund filed in connection with the resolution of any Tax Matter in accordance with Section 13.04(b).

(d) Post-Closing Access and Cooperation. From and after the Closing Date, GRE agrees, and agrees to cause SRE, to permit MP and the MP Representative to have reasonable access, during normal business hours, to the books and records of SRE, to the extent that such books and records relate to a period prior to or ending on the Closing Date, and personnel, for the purpose of enabling MP to: (i) prepare the Tax Returns specified in Section 13.04(a)(i), and (ii) investigate or contest any Tax Matter which MP has the authority to conduct under Section 13.04(b).

ARTICLE 14

MISCELLANEOUS

14.01 **Survival of Representations, Warranties and Covenants**. Except as otherwise provided in this Agreement: (a) all covenants and agreements of the parties contained in this Agreement shall survive the Closing in accordance with their terms, and (b) the representations and warranties of each of the parties contained in this Agreement or contained in any document or certificate given under this Agreement as well as the right of the other party to rely thereon shall survive the Closing for a period of twelve (12) months from the Closing Date; provided, that with respect to any claim made in writing within such twelve (12) month period, such representations and warranties shall survive until a final and binding resolution of such claim has been determined. Further, notwithstanding the foregoing, (i) the representations and warranties contained in Sections 9.05 and 10.02 shall survive until the expiration of any and all applicable statutes of limitations periods on the subject matter of the representation or warranty (or in the event of a claim or an assessment or reassessment, until a final and binding resolution of all matters in relation thereto is made), and (ii) the representations and warranties contained in Sections 9.01, 9.03 and 10.01 shall continue indefinitely.

14.02 **No Broker**. GRE represents to MP, and MP represents to GRE, that neither has engaged, or incurred any unpaid liability to, any broker, finder or consultant in connection with this transaction. MP shall indemnify the GRE and its directors, officers, shareholders and employees and will hold them harmless from and against any claims by any broker, finder or consultant deemed to be engaged by MP for a brokerage fee, finder's fee or the like. GRE shall indemnify MP and will hold it harmless from and against any claims by any broker, finder or consultant deemed to be engaged by GRE for a brokerage fee, finder's fee or the like.

14.03 **Expenses**. Except as otherwise provided herein, the parties shall each pay all of their respective legal, accounting and other expenses incurred in connection with the transactions contemplated by this Agreement.

14.04 **Notices**. Any notice or other communication required or permitted hereunder shall be in writing and delivered personally or by a recognized international overnight courier service, addressed as follows or to such other address as a party shall specify for this purpose in a notice given in the same manner:

(a) To MP:

Minnesota Power
30 West Superior Street
Duluth, MN 55802
Attn: Mr. Donald J. Shippar, President
Facsimile: (218) 723-3960

with copies to:

Mr. Steven W. Tyacke
30 West Superior Street
Duluth, MN 55802
Facsimile: (218) 723-3955

Briggs and Morgan, P.A.
2200 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
Attn: Michael J. Grimes
Facsimile: (612) 977-8650

(b) To GRE:

Great River Energy
17845 East Highway 10
Elk River, MN 55330
Attn: David J. Saggau, Vice President and General Counsel
Facsimile: (763) 241-3732

with copies to:

Moss & Barnett, P.A.
4800 Wells Fargo Center
Minneapolis, MN 55402
Attn: Eric J. Olsen
Facsimile: (612) 339-6686

Any notice given pursuant to this Section shall be deemed given when delivered.

14.05 **Binding Effect; No Assignment Without Prior Written Consent**. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns, but may not be assigned or otherwise transferred by any party without the written consent of the other party.

14.06 **Entire Agreement**. This Agreement, the Ancillary Documents and the Binding Provisions of the Interim Agreement, and the Exhibits and schedules hereto or expressly contemplated hereby contain the entire understanding of the parties relating to the withdrawal transaction and supersede all prior written or oral and all contemporaneous oral agreements and understandings relating to the subject matter hereof, including the non-binding provisions of the Interim Agreement. All statements of fact of the parties contained in any schedule or Ancillary Document under this Agreement to be delivered in connection with the transactions contemplated hereby will constitute representations and warranties of the parties under this Agreement. The Exhibits, schedules and the Recitals to this Agreement are hereby incorporated by reference into and made a part of this Agreement for all purposes.

14.07 **Choice of Law**. This Agreement shall be interpreted under the internal laws of the State of Minnesota without regard to any conflicts of law rule or principle that might result in the application of the law of another jurisdiction.

14.08 **Amendment; Waiver**. This Agreement may be amended, supplemented or modified, and any provision hereof may be waived, only by written instrument making specific reference to this Agreement signed by the party against whom enforcement is sought. No waiver of any of the provisions of this Agreement shall be deemed to or shall constitute a waiver of any other provision, whether or not similar, nor shall any waiver constitute a continuing waiver unless so specified in writing.

14.09 **Pre Closing and Post Closing Cooperation**. Before and after Closing, each of the parties agree that, at the reasonable request of the other party, it shall take such actions and furnish such additional documents and instruments as may be necessary or reasonably desirable to supplement the schedules to this Agreement and/or otherwise effectuate the transactions contemplated by this Agreement and the smooth transition of the Business to the sole ownership of GRE. In the event that the MPUC or other regulatory agency has questions or inquiries about this Agreement or asserts jurisdiction, GRE, on its own behalf and on behalf of SRE, will cooperate with MP to reasonably respond to the MPUC.

14.10 **Counterparts and Facsimile/Electronic Signatures**. This Agreement and any Ancillary Document may be executed in counterparts and will be effective when at least one counterpart has been executed by each party hereto. This Agreement may be executed in duplicate originals, each of which shall be deemed to be an original instrument. All such counterparts and duplicate originals together shall constitute but one Agreement. The counterparts of this Agreement and any Ancillary Document may be executed and delivered by telecopy or other electronic transmission, and the receiving party may rely on receipt of such executed document as if the original had been received.

14.11 **Interpretation**. The article and section headings contained in this Agreement are solely for the purpose of reference, are not part of the agreement of the parties and will not in any way affect the meaning or interpretation of this Agreement. Whenever the singular form of a word is used in this Agreement, that word will include the plural form of that word. The term "or" will not be interpreted as excluding any of the items described. The term "include" or any derivative of such term does not mean that the items following such term are the only types of such items. Neither this Agreement nor any provision contained in this Agreement will be interpreted in favor of or against any party hereto because such party or its legal counsel drafted this Agreement or such provision. Whenever the plural form of a word is used in this Agreement, that word will include the singular form of that word.

14.12 **Payments**. Any payments to be made by one party to the other hereunder, or by SRE to MP, shall be made in U.S. funds either by (i) certified or bank official check, or (ii) wire transfer of immediately available funds, at the remitting party's option.

14.13 **Termination of Withdrawal Agreement**. The Withdrawal Agreement is hereby terminated and replaced in its entirety by this Agreement. This termination shall not be

interpreted, and is not, a termination contemplated by Article 12 of the Withdrawal Agreement, and no terms of the Withdrawal Agreement shall survive this termination.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, this Agreement has been executed the day and year first above written.

MINNESOTA POWER

By: /s/ Donald Shippar
Donald Shippar
President

GREAT RIVER ENERGY

By: /s/ James Van Epps
James Van Epps
Chief Executive Officer

[SIGNATURE PAGE TO AMENDED AND RESTATED WITHDRAWAL AGREEMENT]

THIRD AMENDED AND RESTATED COMMITTED FACILITY LETTER

December 23, 2003

ALLETE, Inc.
30 West Superior Street
Duluth, Minnesota 55802
Attn: Corporate Treasurer

Ladies and Gentlemen:

Reference is hereby made to that certain Second Amended and Restated Committed Facility Letter among the banks party thereto, ABN AMRO Bank N.V., as agent for such banks and yourselves dated as of December 24, 2002, as amended from time to time (together with all exhibits, schedules, attachments, appendices and amendments thereof, the *"Existing Committed Facility Letter"*). The parties to the Existing Committed Facility Letter desire that the Existing Committed Facility Letter be amended and restated in its entirety, without constituting a novation, all on the terms and conditions contained herein. Accordingly, in consideration of the premises and the agreements, provisions and covenants contained herein, the Existing Committed Facility Letter is hereby amended and restated in its entirety to be and to read as follows:

LaSalle Bank National Association (the "Agent" and, in its individual capacity, a "Bank") and the other Banks (as defined below) are pleased to advise ALLETE, Inc. (the "Company") that the Banks (defined below) have severally approved, subject to the conditions outlined in this letter, a committed credit facility (the "Facility"). The amount available under the Facility shall not exceed at any time the aggregate sum of the Commitments (defined below). This Facility shall terminate on December 21, 2004 (the *"Termination Date"*). The Facility shall be available under the following terms and conditions (certain capitalized terms being used and not otherwise defined as set forth in Section 8):

1. LOANS.

The Company may from time to time before the Termination Date borrow Eurodollar Loans, or if one or more conditions exist as set forth in Section 3(b) or Section 3(c) hereof, Prime Rate Loans. The aggregate outstanding amount of the Loans shall not at any time exceed the aggregate sum of the Commitments. The Company may borrow, repay and reborrow in accordance with the terms hereof.

a. Borrowing Procedures

i. Prime Rate Loans. Each Prime Rate Loan shall be on prior telephonic notice (promptly confirmed in writing) from any Authorized Officer received by the Agent not later than 11:00 a.m. (Chicago, Illinois time), on the day such Loan is to be made. Each such Notice of Borrowing shall specify (i) the

borrowing date, which shall be a Banking Day, and (ii) the amount of the Loan. Each Prime Rate Loan shall be in the amount of $5,000,000 or a higher integral multiple of $1,000,000. A Prime Rate Loan shall only be available if the Agent has given written notice to the Company that one or more conditions exist as set forth in Section 3(b) or Section 3(c) hereof.

ii. Eurodollar Loans. Each Eurodollar Loan shall be made upon at least three Banking Days' prior written or telephonic notice from any Authorized Officer received by the Agent not later than 3:00 p.m. (Chicago, Illinois time). Each such Notice of Borrowing shall specify (i) the borrowing date, which shall be a Banking Day, (ii) the amount of such Loan, and (iii) the Interest Period for such Loan. Each Eurodollar Loan shall be in the amount of $5,000,000 or a higher integral multiple of $1,000,000.

iii. The Agent shall give prompt telephonic or telecopy notice to each Bank of the contents of each Notice of Borrowing and of such Bank's share of such Loan.

iv. Not later than 11:00 a.m. (Chicago time) (or 1:00 p.m. (Chicago time) in the case of any Prime Rate Loan) on the date of each borrowing, each Bank participating therein shall (except as provided in subsection (v) of this Section) make available its share of such Loan, in Federal or other funds immediately available in Chicago, to the Agent at its address set forth next to its signature below. Unless the Agent is notified by a Bank that any applicable condition specified in Section 4 has not been satisfied, the Agent will make the funds so received from the Banks available to the Company by depositing such funds in the manner specified in the related Notice of Borrowing.

v. Unless the Agent shall have received notice from a Bank prior to the date of any borrowing that such Bank will not make available to the Agent such Bank's share of such Loan, the Agent may assume that such Bank has made such share available to the Agent on the date of such borrowing in accordance with subsection (iv) of this Section 1(a), and the Agent may, in reliance upon such assumption (but shall not be obligated to), make available to the Company on such date a corresponding amount. If and to the extent that such Bank shall not have so made such share available to the Agent, such Bank and the Company severally agree to repay to the Agent forthwith on demand such corresponding amount together with interest thereon, for each day from the date such amount is made available to the Company until the date such amount is repaid to the Agent, at (i) in the case of the Company, a rate per annum equal to the higher of (x) the Prime Rate and (y) the interest rate applicable thereto pursuant to Section 1(b)(ii), and (ii) in the case of such Bank, the Prime Rate. If such Bank shall repay to the

Agent such corresponding amount, such amount so repaid shall constitute such Bank's Loan included in such Loan for purposes of this Agreement.

b. Interest

i. Prime Rate Loans. The unpaid principal of each Prime Rate Loan shall bear interest prior to maturity at a rate per annum equal to the Prime Rate in effect from time to time plus the Applicable Margin. Accrued interest on Prime Rate Loans shall be payable quarterly on the 30th day of each December, March, June and September and at maturity.

ii. Eurodollar Loans. The unpaid principal amount of each Eurodollar Loan shall bear interest prior to maturity at a rate per annum equal to LIBOR in effect for the Interest Period with respect to such Eurodollar Loan plus the Applicable Margin. Accrued interest on each Eurodollar Loan shall be payable on the last day of the Interest Period applicable to such Loan and, if such Interest Period shall exceed three months, at three month intervals after the date of the Eurodollar Loan.

iii. Interest After Maturity. Any principal of any Loan which is not paid when due, whether at the stated maturity, upon acceleration or otherwise, shall bear interest from and including the date such principal shall have become due to (but not including) the date of payment thereof in full at a rate per annum equal to the Prime Rate from time to time in effect plus the Applicable Margin plus 2% per annum (but until the end of any Interest Period for a Eurodollar Rate Loan, not less than 2 % in excess of the rate otherwise applicable for such Loan). After maturity, accrued interest shall be payable on demand.

iv. Maximum Rate. In no event shall the interest rate applicable to any amount outstanding hereunder exceed the maximum rate of interest allowed by applicable law, as amended from time to time. Any payment of interest or in the nature of interest in excess of such limitation shall be credited as a payment of principal unless the Company shall request the return of such amount.

v. Method of Calculating Interest and Fees. Interest on each Loan shall be computed on the basis of a year consisting of (i) 365/366, as applicable, days for Prime Rate Loans, and (ii) 360 days for Eurodollar Loans, and paid for actual days elapsed. Fees shall be computed on the basis of a year consisting of 360 days and paid for actual days elapsed.

c. Disbursements and Payments

The Agent shall transfer the proceeds of each Loan as directed by an Authorized Officer. Each Eurodollar Loan shall be payable on the earlier of the last day of the Interest Period

applicable thereto or the Termination Date. Each Prime Rate Loan shall be payable on the Termination Date. All payments to the Banks shall be made to the Agent at LaSalle Bank National Association ABA No. 071 000 505, Account No. 1378018, reference ALLETE not later than 2:00 p.m., Chicago, Illinois time, on the date when due and shall be made in lawful money of the United States of America (in freely transferable U.S. dollars) and in immediately available funds. Any payment that shall be due on a day, which is not a Banking Day, shall be payable on the next Banking Day, subject to the definition of "Interest Period".

d. Prepayment; Commitment Reductions

The Company may prepay any Loan in whole or in part from time to time (but, if in part, in an amount not less than $1,000,000 and integral multiples of $1,000,000 in excess thereof) without premium or penalty (subject to the following paragraph) upon (i) 3 Business Days prior written notice to the Agent with respect to any Eurodollar Loan and (ii) prior written notice delivered to the Agent prior to 10:00 a.m. (Chicago, Illinois time) on the date of such prepayment with respect to any Prime Rate Loan.

If the Company shall prepay any Loan, it shall pay to the Agent at the time of each prepayment, or at such later time designated by the Agent, any and all costs described in Section 3(g) hereof.

The Company may reduce the amount of Commitments from time to time in amounts not less than $1,000,000 and integral multiples of $1,000,000 in excess thereof without premium or penalty upon (i) 3 Business Days prior written notice to the Agent, provided that the aggregate amount of Commitments shall not exceed the aggregate principal amount of Loans then outstanding. Any such reduction shall be applied ratably to the Commitments of the Banks and may not be reinstated.

e. Note

The Company's obligations with respect to the Loans shall be evidenced by a note for each Bank in the form attached as Exhibit A (each, a "Note" and, collectively, the "Notes"). The amount, the rate of interest for each Loan and the Interest Period (if applicable) shall be endorsed by the respective Bank on the schedule attached to its Note, or at any Bank's option, in its records, which schedule or records shall be conclusive, absent manifest error, *provided, however*, that the failure of any Bank to record any of the foregoing or any error in any such record shall not limit or otherwise affect the obligation of the Company to repay all Loans made to it hereunder together with accrued interest thereon.

2. FEES.

a. Certain Fees

The Company shall pay, or cause to be paid, to the Agent certain fees set forth in the Fee Letter at the time specified in the Fee Letter for payment of such amounts.

b. Facility Fee

The Company agrees to pay to the Banks a facility fee at the Fee Rate on the amount of the Facility (whether or not used). Such facility fee shall be payable by the Company quarterly on the 30th day of each December, March, June and September after the date hereof and on the Termination Date as set forth in Section 1(c) hereof.

c. Utilization Fee

For each day the aggregate amount of Loans outstanding exceeds 33% of the Commitments as in effect on such day, the Company agrees to pay to the Banks, in addition to any other amounts payable hereunder, a utilization fee on the aggregate outstanding amount of Loans on such date at a rate per annum equal to the Utilization Fee Rate. Such utilization fee shall be payable by the Company on the date when the next interest payment on such Loans is due in accordance with Section 1(b) hereof and on the Termination Date as set forth in Section 1(c) hereof.

3. ADDITIONAL PROVISIONS RELATING TO LOANS.

a. Increased Cost

The Company agrees to reimburse each Bank for any increase in the cost to such Bank of, or any reduction in the amount of any sum receivable by such Bank in respect of, making or maintaining any Eurodollar Loans (including the imposition, modification or deemed applicability of any reserves, deposits or similar requirements). The additional amount required to compensate any Bank for such increased cost or reduced amount shall be payable by the Company to such Bank within five days of the Company's receipt of written notice from such Bank specifying such increased cost or reduced amount and the amount required to compensate such Bank therefor, which notice shall, in the absence of manifest error, be conclusive and binding on the Company. In determining such additional amount, a Bank may use reasonable averaging, attribution and allocation methods.

b. Deposits Unavailable or Interest Rate Unascertainable; Impracticability

If the Company has notified the Agent of its intention to borrow a Eurodollar Loan for an Interest Period and the Agent or any Bank determines (which determination shall be conclusive and binding on the Company) that:

(1) deposits of the necessary amount for such Interest Period are not available to such Bank in the London interbank market or, by reason of circumstances affecting such market, adequate and reasonable means do not exist for ascertaining the Eurodollar Rate for such Interest Period; or

(2) LIBOR will not adequately and fairly reflect the cost to the Bank of making or funding a Eurodollar Loan for such Interest Period; or

(3) the making or funding of Eurodollar Loans has become impracticable as a result of any event occurring after the date of this Agreement which, in the opinion of the Bank, materially and adversely affects such Loans or the interbank eurodollar market;

then any notice of a Eurodollar Loan previously given by the Company and not yet borrowed shall be deemed to be a notice to make a Prime Rate Loan.

c. Changes in Law Rendering Eurodollar Loans Unlawful

If at any time due to the adoption of, or change in, any law, rule, regulation, treaty or directive or in the interpretation or administration thereof by any court, central bank, governmental authority or governmental agency charged with the interpretation or administration thereof, or for any other reason arising subsequent to the date hereof, it shall become (or, in the good faith judgment of any Bank, raise a substantial question as to whether it is) unlawful for such Bank to make or fund any Eurodollar Loan, Eurodollar Loans shall not be made hereunder for the duration of such illegality. If any such event shall make it unlawful for any Bank to continue any Eurodollar Loans previously made by it hereunder, the Company shall, after being notified by such Bank of the occurrence of such event, on such date as shall be specified in such notice, either convert such Eurodollar Loan to a Prime Rate Loan or prepay in full such Eurodollar Loan, together with accrued interest thereon, without any premium or penalty (except as provided in Section 3(g)).

d. Discretion of the Banks as to Manner of Funding

Each Bank shall be entitled to fund and maintain its funding of all or any part of the Loans in any manner it sees fit; it being understood, however, that for purposes of this Note, all determinations hereunder shall be made as if such Bank had actually funded and maintained each Eurodollar Loan during the Interest Period for such Eurodollar Loan through the purchase of deposits having a term corresponding to such Interest Period and bearing an interest rate equal to LIBOR for such Interest Period.

e. Taxes

All payments by the Company of principal of, and interest on, the Loans and all other amounts payable hereunder shall be made free and clear of and without deduction for any present or future income, excise, stamp or franchise taxes and other taxes, fees, duties,

withholdings or other charges of any nature whatsoever imposed by any taxing authority, but excluding franchise taxes and taxes imposed on or measured by each respective Bank's net income or receipts (such non-excluded items being called "Taxes"). If any withholding or deduction from any payment to be made by the Company hereunder is required in respect of any Taxes pursuant to any applicable law, rule or regulation, then the Company will

i. pay directly to the relevant authority the full amount required to be so withheld or deducted;

ii. promptly forward to each Bank an official receipt or other documentation satisfactory to such Bank evidencing such payment to such authority; and

iii. pay to each Bank such additional amount or amounts as is necessary to ensure that the net amount actually received by such Bank will equal the full amount such Bank would have received had no such withholding or deduction been required.

Moreover, if any Taxes are directly asserted against any Bank or on any payment received by such Bank hereunder, such Bank may pay such Taxes and the Company will promptly pay such additional amount (including any penalty, interest or expense) as is necessary in order that the net amount received by such Bank after the payment of such Taxes (including any Taxes on such additional amount) shall equal the amount such Bank would have received had no such Taxes been asserted.

If the Company fails to pay any Taxes when due to the appropriate taxing authority or fails to remit to any Bank the required receipts or other required documentary evidence, the Company shall indemnify such Bank for any incremental Tax, interest, penalty or expense that may become payable by such Bank as a result of any such failure.

f. Increased Capital Costs

If any change in, or the introduction, adoption, effectiveness, interpretation, reinterpretation or phase-in of, any law or regulation, directive, guideline, decision or request (whether or not having the force of law) of any court, central bank, regulator or other governmental authority affects or would affect the amount of capital required or expected to be maintained by any Bank or any entity controlling any Bank, and such Bank determines (in its sole and absolute discretion) that the rate of return on its or such controlling entity's capital as a consequence of the Loans made by such Bank or the commitment hereunder is reduced to a level below that which such Bank or such controlling entity could have achieved but for the occurrence of any such circumstance, then, in any such case, upon notice from time to time by any Bank to the Company, the Company shall immediately pay directly to such Bank additional amounts sufficient to compensate such Bank or such controlling entity for such reduction in rate

of return. A statement of any Bank as to any such additional amount or amounts (including calculations thereof in reasonable detail) shall, in the absence of manifest error, be conclusive and binding on the Company. In determining such amount, each Bank may use reasonable averaging, attribution and allocation methods.

g. Funding Losses

The Company will indemnify the Banks upon demand against any loss or expense which any Bank may sustain or incur (including, without limitation, any loss or expense sustained or incurred in obtaining, liquidating or employing deposits or other funds acquired to effect, fund or maintain any Loan) as a consequence of (i) any failure of the Company to make any payment when due of any amount due hereunder, (ii) any failure of the Company to borrow a Loan on a date specified therefor in a notice thereof, or (iii) any payment (including any payment upon any Bank's acceleration of the Loans) or prepayment of any Eurodollar Loan on a date other than the last day of the Interest Period for such Loan.

4. CONDITIONS PRECEDENT.

a. Initial Loan

The obligation of each Bank to make the initial Loan shall be subject to the prior or concurrent satisfaction of each of the following conditions precedent:

i. The Company shall have delivered to the Agent a certificate dated the date of the initial Loan of its Secretary or Assistant Secretary as to (i) resolutions of its Board of Directors then in full force and effect authorizing the execution, delivery and performance of this Agreement, the Notes, and each of the other Loan Documents; and (ii) the incumbency and signatures of those of its officers authorized to act with respect to this Agreement, the Note and each of the Loan Documents executed by it, upon which certificate the Banks may conclusively rely until it shall have received a further certificate of the Secretary or Assistant Secretary of the Company canceling or amending such prior certificate.

ii. Each Bank shall have received its respective Note duly executed and delivered by the Company.

iii. The Agent shall have received an opinion dated the date of the initial Loan from counsel to the Company in form satisfactory to the Agent.

iv. The Company shall have paid to the Agent, for the account of the Banks, a renewal fee equal to 0.20% of the Commitments in effect on the date hereof, such fee to be distributed to the Banks based upon their share of the Commitments on the date hereof.

b. Each Loan

The obligation of each Bank to make any Loan (including the initial Loan) shall be subject to the following statements being true and correct before and after giving effect to such Loan: (i) the representations and warranties set forth in Section 5 shall be true and correct with the same effect as if then made (unless stated to relate solely to an earlier date, in which case such representations and warranties shall be true and correct as of such earlier date); and (ii) no Event of Default or Unmatured Event of Default shall have occurred and be continuing.

Each request for a Loan shall be deemed a representation by the Company, as to the matters set forth in this Section.

5. REPRESENTATIONS.

The Company represents and warrants to the Banks that:

a. Organization

It is a corporation duly organized and in good standing under the laws of its state of organization and duly qualified to do business in each jurisdiction where such qualification is necessary.

b. Authorization

The execution and delivery of this Agreement, the Note and the other Loan Documents and the performance by the Company of its obligations hereunder and thereunder are within the Company's powers and have been duly authorized by all necessary action on the Company's part, and do not and will not contravene or conflict with the Company's organizational documents or violate or constitute a default under any law, rule or regulation any presently existing requirement or restriction imposed by judicial, arbitral or other governmental instrumentality or any agreement, instrument or indenture by which the Company is bound.

c. Enforceability

This Agreement is the Company's legal, valid and binding obligation, enforceable in accordance with its terms.

d. Financial Statements

The audited financial statements of the Company as at December 31, 2002 and the interim financial statements of the Company as at September 30, 2003, copies of which have been furnished to the Agent, have been prepared in accordance with generally accepted accounting principles consistently applied, and present fairly the financial condition of the

Company at the date thereof and the results of its operations for the period then ended. Since the date of such interim financial statements, there has been no Material Adverse Change.

e. Use of Proceeds

The Company agrees that proceeds of any Loan shall be used solely for the purpose of providing liquidity support with respect to commercial paper borrowings of the Company or for other valid general corporate purposes.

6. COVENANTS.

From the date of this Agreement and thereafter until the termination of the Facility and until the Obligations are paid in full, the Company agrees that it will:

a. Financial Information. Furnish to the Agent:

i. As soon as available and in any event within 60 days after the end of each of the first three fiscal quarters of each fiscal year of the Company, consolidated balance sheets of the Company, and internally prepared unaudited consolidating balance sheets of the Company and its subsidiaries, each as at the end of such fiscal quarter, and statements of earnings and cash flow of the Company, and internally prepared unaudited consolidating statements of earnings of the Company and its subsidiaries, each for such quarter and for the period commencing at the beginning of such fiscal year and ending with the end of such quarter, certified by the chief financial officer of the Company;

ii. as soon as available and in any event within 120 days after the end of each fiscal year of the Company, a copy of the annual audit report for such fiscal year for the Company, including balance sheets of the Company as of the end of such fiscal year and statements of earnings and cash flow for such fiscal year, in each case certified in a manner acceptable to the Agent by independent public accountants acceptable to the Agent together with the internally prepared unaudited (a) consolidating balance sheets as of the end of such fiscal year, and (b) statements of earnings for the period commencing at the beginning of such fiscal year and ending with the end of such fiscal year, of the Company and its subsidiaries;

iii. upon the occurrence of a Unmatured Event of Default or Event of Default, notice of such Unmatured Event of Default or Event of Default; and

iv. such other information with respect to the condition or operations, financial or otherwise, of the Company as any Bank may from time to time reasonably request.

b. Further Restrictions on Use of Proceeds

Not, and not permit any Subsidiary or affiliate of the Company to, use the proceeds of any Loan, directly or indirectly, for the purpose of (i) purchasing any securities underwritten or privately placed by ABN AMRO Incorporated ("AAI"), an affiliate of the Agent, (ii) purchasing from AAI any securities in which AAI makes a market or (iii) refinancing or making payments of principal, interest or dividends on any securities issued by the Company, or any Subsidiary or affiliate of the Company, and underwritten, privately placed or dealt in by AAI.

c. Prohibition of Fundamental Changes. The Company shall not:

i. Enter into any transaction of merger of consolidation or amalgamation, or liquidate, wind up or dissolve itself (or suffer any liquidation or dissolution); or

ii. Convey, sell, lease, transfer or otherwise dispose of, in one transaction or a series of transactions, all or a substantial portion of its business or property without the prior written consent of the Required Banks, which consent shall not be unreasonably withheld.

Notwithstanding the foregoing provisions of this subsection (c), the Company may (x) merge or consolidate with any other Person if the Company is the surviving corporation or the surviving corporation assumes the liabilities of the Company by operation of law or otherwise, and (y) so long as no Unmatured Event of Default or Event of Default has occurred and is continuing, or would result therefrom, the Company may spin-off its automotive services division into a publicly traded company.

d. Maximum Ratio of Funded Debt to Total Capital

The Company shall at all times, measured as of the end of each fiscal quarter of the Company and immediately after the spin-off of its automotive division,, maintain a maximum ratio of Funded Debt to Total Capital of .60 to 1.0.

e. Interest Coverage Ratio

The Company shall maintain at all times an Interest Coverage Ratio of not less than 3.00 to 1.00, as determined at the end of each fiscal quarter of the Company.

7. EVENTS OF DEFAULT.

a. Events. Each of the following shall constitute an Event of Default:

i. The Company fails to pay when due any principal of, or interest on, any Loan or any other amount payable hereunder or under any Note;

ii. Any material representation or warranty of the Company made or deemed made hereunder or under any other writing or certificate furnished by or on behalf of the Company to the Agent for the purposes of or in connection with this Agreement shall prove to have been false or misleading in any material respect when made or deemed made;

iii. The Company defaults in the due performance or observance of Section 6(b) hereof or the Company defaults in any material respect in the due performance or observance of any other agreement contained herein or in any other Loan Document and such default shall continue for 30 days after notice thereof shall have been given to the Company from the Agent;

iv. The maturity of any indebtedness of the Company under any agreement or obligation in an aggregate principal amount exceeding $5,000,000 shall be accelerated, or any default shall occur under one or more agreements or instruments under which such indebtedness may be issued or created and such default shall continue for a period of time sufficient to permit the holder or beneficiary of such indebtedness or a trustee therefor to cause the acceleration of the maturity of such indebtedness or any mandatory unscheduled prepayment, purchase or funding thereof;

v. Judgments or orders for the payment of money in excess of $5,000,000 shall be rendered against the Company and such judgments or orders shall continue unsatisfied and unstayed for a period of 30 days:

vi. The Company or any Subsidiary shall

(1) become insolvent or generally fail to pay, or admit in writing its inability or unwillingness to pay, debts as they become due;

(2) apply for, consent to or acquiesce in the appointment of a trustee, receiver, sequestrator or other custodian for the Company or any Subsidiary or any property thereof, or make a general assignment for the benefit of creditors;

(3) in the absence of such application, consent or acquiescence, permit or suffer to exist the appointment of a trustee, receiver, sequestrator or other custodian for the Company or any Subsidiary or for a substantial

part of the property thereof, and such trustee, receiver, sequestrator or other custodian shall not be discharged within 30 days;

(4) permit or suffer to exist the commencement of any bankruptcy, reorganization, debt arrangement or other case or proceeding under any bankruptcy or insolvency law, or any dissolution, winding up or liquidation proceeding, in respect of the Company or any Subsidiary and, if any such case or proceeding is not commenced by the Company or such Subsidiary, such case or proceeding shall be consented to or acquiesced in by the Company or such Subsidiary or shall result in the entry of an order for relief or shall remain for 60 days undismissed; or

(5) take any action authorizing, or in furtherance of, any of the foregoing; or

vii. any Material Adverse Change shall have occurred.

b. Remedies

Upon the occurrence of an Event of Default under Section 7(a)(vi), the commitment of the Banks to make Loans shall be terminated and the Notes and all other obligations hereunder shall become immediately due and payable in full; and upon the occurrence of any other Event of Default, the commitment of the Banks to make Loans may be terminated by the Banks and the Agent tray declare the Notes and the principal of and accrued interest on each Loan, and all other amounts payable hereunder, to be forthwith due and payable in full.

8. DEFINITIONS.

As used in this Agreement:

"Agent" means LaSalle Bank National Association, in its capacity as Agent for the Banks hereunder, and its successors in such capacity.

"Applicable Margin" means (i) with respect to Eurodollar Loans, (a) 0.525% per annum for any day Level I Status exists; (b) 0.750% per annum for any day Level II Status exists; (c) 0.850% per annum for any day Level III Status exists; (d) 1.300% per annum for any day Level IV Status exists; and (e) 2.000% per annum for any day Level V Status exists; and (ii) with respect to Prime Rate Loans, (a) 0.000% per annum for any day Level I Status exists; (b) 0.000% per annum for any day Level II Status exists; (c) 0.000% per annum for any day Level III Status exists; (d) 0.500% per annum for any day Level IV Status exists; and (e) 1.500% per annum for any day Level V Status exists.

"Authorized Officer" means each officer or employee of the Company who is authorized to request Loans, to confirm in writing any such request and to agree to rates of

interest, as set forth on the schedule of Authorized Officers most recently delivered by the Company to the Agent.

"Bank" means each bank listed on the signature page hereof, or which subsequently becomes a party hereto by execution of a Joinder Agreement, and its successors and assigns.

"Banking Day" means any day other than a Saturday, Sunday or other day on which the Banks are required or permitted to close in Chicago and, with respect to Eurodollar Loans on which dealings in Dollars are carried on in the London interbank market.

"Commitment" means, with respect to each Bank, the amount set forth opposite the name of such Bank on the signature pages hereof, or on a Joinder Agreement, as applicable.

"Consolidated EBITDA" means, for any period, for the Company and its subsidiaries (which for purposes of this definition shall include any subsidiary consolidated into the financial statements of the Company other than ALLETE Water Services, Inc. and any other subsidiary of the Company as to which the Company has announced on or prior to December 15, 2002 that it will discontinue the operations of such subsidiary) on a consolidated basis, (A) the sum of the amounts for such period of (i) Consolidated Net Income, (ii) to the extent deducted in arriving at Consolidated Net Income, net federal, state and local income taxes in respect of such period, (iii) to the extent deducted in arriving at Consolidated Net Income, Consolidated Interest Expense, (iv) to the extent deducted in arriving at Consolidated Net Income, the amount charged for the amortization of intangible assets, (v) to the extent deducted in arriving at Consolidated Net Income, the amount charged for the depreciation of assets, and (vi) to the extent deducted in arriving at Consolidated Net Income, extraordinary losses, less (B) the amount for such period of, to the extent added in arriving at Consolidated Net Income, extraordinary gains, all as determined on a consolidated basis in accordance with GAAP.

"Consolidated Interest Expense" means, with reference to any period of the Company and its subsidiaries (which for purposes of this definition shall include any subsidiary consolidated into the financial statements of the Company other than ALLETE Water Services, Inc. and any other subsidiary of the Company as to which the Company has announced on or prior to December 15, 2002 that it will discontinue the operations of such subsidiary), the sum of (i) all interest charges (including capitalized interest, imputed interest charges with respect to capitalized leases and all amortization of debt discount and expense and other deferred financing charges) of the Company and its subsidiaries on a consolidated basis, and (ii) all commitment or other fees payable in respect of the issuance of standby letters of credit or other credit facilities for the account of the Company or its subsidiaries, all as determined on a consolidated basis in accordance with GAAP.

"Consolidated Net Income" means, for any period of the Company and its subsidiaries (which for purposes of this definition shall include any subsidiary consolidated into

the financial statements of the Company other than ALLETE Water Services, Inc. and any other subsidiary of the Company as to which the Company has announced on or prior to December 15, 2002 that it will discontinue the operations of such subsidiary), the amount for such period of consolidated net income (or net loss) of the Company and its subsidiaries, as determined on a consolidated basis in accordance with GAAP.

"Eurodollar Loan" means any Loan which bears interest at a rate determined with reference to LIBOR (plus the Applicable Margin).

"Event of Default" means an event described in Section 7(a).

"Facility" has the meaning set forth in the initial paragraph of this Agreement.

"Federal Funds Rate" means, the per annum rate at which overnight federal funds are from time to time offered to the Agent by any bank in the interbank market, as stated by the Agent.

"Fee Letter" means that certain letter between the Borrower and LaSalle Bank National Association and its affiliates relating to certain fees to be paid by the Borrower to, and solely for the account of, LaSalle Bank National Association and its affiliates, as such letter may from time to time be amended.

"Fee Rate" means a rate per annum equal to (i) 0.100% per annum for any day Level I Status exists; (ii) 0.125% per annum for any day Level II Status exists; (iii) 0.150% per annum for any day Level III Status exists; (iv) 0.200% per annum for any day Level IV Status exists; and (v) 0.500% per annum for any day Level V Status exists.

"Funded Debt" means, for any entity on a consolidated basis (without duplication): (i) all indebtedness of such entity for borrowed money; (ii) the deferred and unpaid balance of the purchase price owing by such entity on account of any assets or services purchased (other than trade payables and other accrued liabilities incurred in the ordinary course of business that are not overdue by more than 180 days unless being contested in good faith) if such purchase price is (A) due more than nine months from the date of incurrence of the obligation in respect thereof or (B) evidenced by a note or a similar written instrument; (iii) all capitalized lease obligations; (iv) all indebtedness secured by a Lien on any property owned by such entity, whether or not such indebtedness has been assumed by such entity or is nonrecourse to such entity; (v) notes payable and drafts accepted representing extensions of credit whether or not representing obligations for borrowed money (other than such notes or drafts from the deferred purchase price of assets or services to the extent such purchase price is excluded from clause (ii) above); (vi) indebtedness evidenced by bonds, notes or similar written instrument; (vii) the face amount of all letters of credit and bankers' acceptances issued for the account of such entity, and without duplication, all drafts drawn thereunder (other than such letters of credit, bankers' acceptances and drafts for the deferred purchase price of assets or services to the extent

such purchase price is under interest rate agreements or currency agreements); (viii) guaranty obligations of such entity with respect to indebtedness for borrowed money of another entity (including affiliates) in excess of $25,000,000 in the aggregate; provided, however, that in no event shall any calculation of Funded Debt include (a) deferred taxes, (b) securitized trade receivables, (c) deferred credits including regulatory assets and contributions in aid of construction, (d) the lease obligations for Lake Superior Paper, Inc. relating to paper mill equipment as provided for under an operating lease extending to 2012 or (e) 75% of the indebtedness associated with Square Butte.

"GAAP" means generally accepted accounting principles as in effect in the United States from time to time, applied by the Company and any subsidiary on a basis consistent with the preparation of the Company's financial statements furnished to the Agent.

"Interest Coverage Ratio" means, for any period of four consecutive fiscal quarters of the Company ending with the most recently completed such fiscal quarter, the ratio of (A) Consolidated EBITDA to (B) Consolidated Interest Expense for such period.

"Interest Period" means for any Eurodollar Loan, a period of one, two, three or six months, as designated by the Company, in each case commencing on the date of such Loan. Each Interest Period that would otherwise end on a day which is not a Banking Day shall end on the next succeeding Banking Day unless such next Banking Day would be the first Banking Day in the next calendar month, in which case such Interest Period shall end on the preceding Banking Day. Any Interest Period for a Eurodollar Loan which begins on the last Banking Day of a calendar month (or on a day for which there is no numerically corresponding day in the calendar month at the end of such Interest Period) shall end on the last Banking Day of the calendar month at the end of such Interest Period. No Interest Period shall extend beyond the Termination Date, and in such case, the Termination Date shall be deemed the end of the Interest Period.

"Joinder Agreement" means a joinder agreement in the form attached hereto as Exhibit "B."

"Level I Status" means, subject to Section 9(r) hereof, the S&P Rating is A- or higher and the Moody's Rating is A3 or higher.

"Level II Status" means, subject to Section 9(r) hereof, Level I Status does not exist, but the S&P Rating is BBB+ or higher and the Moody's Rating is Baa1 or higher.

"Level III Status" means, subject to Section 9(r) hereof, neither Level I Status nor Level II Status exists, but the S&P Rating is BBB or higher and the Moody's rating is Baa2 or higher.

"Level IV Status" means, subject to Section 9(r) hereof, none of Level I Status, Level II Status nor Level III Status exists, but the S&P Rating is BBB- or higher and the Moody's Rating is Baa3 or higher.

"Level V Status" means, subject to Section 9(r) hereof, none of Level I Status, Level II Status, Level III Status nor Level IV Status exists.

"LIBOR" means a rate of interest equal to the per annum rate of interest at which United States dollar deposits in an amount comparable to the principal balance of the Eurodollar Loan to be made by the Agent in its capacity as a Bank and for a period equal to the relevant Interest Period are offered in the London Interbank Eurodollar market at 11:00 a.m. (London time) two Business Days prior to the commencement of each Interest Period, as displayed in the Bloomberg Financial Markets system, or other authoritative source selected by the Agent in its reasonable discretion, divided by a number determined by subtracting from 1.00 the maximum reserve percentage for determining reserves to be maintained by member banks of the Federal Reserve System for Eurocurrency liabilities, such rate to remain fixed for such Interest Period. The Agent's determination of LIBOR shall be conclusive, absent manifest error

"Loan" means a loan made pursuant to Section 1.

"Loan Documents" means this Agreement, the Notes and each other agreement, document or instrument delivered in connection with this Agreement.

"Material Adverse Change" means any change in the business, organization, assets, properties or condition (financial or other) of the Company which could materially and adversely affect the Company's ability to perform hereunder including, without limitation, representations, warranties, covenants and payment of Obligations, it being agreed that the Company's spin-off its automotive services division into a publicly traded company in accordance with Sections 6(c) and (d) hereof shall not constitute a Material Adverse Change.

"Moody's Rating" means the rating assigned by Moody's Investors Service, Inc. and any successor thereto that is a nationally recognized rating agency to the outstanding senior unsecured non-credit enhanced long-term indebtedness of the Company (or if neither Moody's Investors Service, Inc. nor any such successor shall be in the business of rating long-term indebtedness, a nationally recognized rating agency in the U.S. as mutually agreed between the Agent and the Company). Any reference in this Agreement to any specific rating is a reference to such rating as currently defined by Moody's Investors Service, Inc. (or such a successor) and shall be deemed to refer to the equivalent rating if such rating system changes.

"Note" has the meaning set forth in Section 1.5.

"Notice of Borrowing" means a notice from the Company to the Agent requesting the making of a Loan and which is delivered pursuant to Section 1(a)(i) or Section 1(a)(ii) hereof.

"Obligations" means all obligations (monetary or otherwise) of the Company arising under or in connection with this Agreement, the Notes and each of the other Loan Documents.

"Prime Rate" means a floating rate of interest equal to the higher (redetermined daily) of (i) the per annum rate of interest announced by the Agent from time to time at its principal office in Chicago as its prime rate for Dollar loans or (ii) the Federal Funds Rate plus 0.5%. (The "prime rate" is set by the Agent based upon various factors and is used as a reference point for pricing some loans. It is not necessarily the best rate available to the Agent's customers at any point in time.)

"Prime Rate Loan" means any Loan which bears interest at a rate determined by reference to the Prime Rate.

"Required Banks" means, at any time, Banks having at least 66-2/3% of the aggregate amount of the Commitments.

"S&P Rating" means the rating assigned by Standard & Poor's Ratings Group, a division of The McGraw-Hill Companies, Inc. and any successor thereto that is a nationally recognized rating agency to the outstanding senior unsecured non-credit enhanced long-term indebtedness of the Company (or, if neither such division nor any successor shall be in the business of rating long-term indebtedness, a nationally recognized rating agency in the U.S. as mutually agreed between the Agent and the Company). Any reference in this Agreement to any specific rating is a reference to such rating as currently defined by Standard & Poor's Ratings Group, a division of The McGraw-Hill Companies, Inc. (or such a successor) and shall be deemed to refer to the equivalent rating if such rating system changes.

"Subsidiary" means ALLETE Automotive Services, Inc.

"Taxes" has the meaning set forth in Section 3(e).

"Total Capital" means the sum of retained earnings, stockholders' equity (including preferred stock and QUIPs), all determined with respect to the Company and its subsidiaries on a consolidated basis in accordance with GAAP consistently applied, and Funded Debt.

"Unmatured Event of Default" means an event which with notice, the lapse of time or both would constitute an Event of Default.

"Utilization Fee Rate" means a rate equal to (i) 0.125% per annum for any day Level I Status exists; (ii) 0.125% per annum for any day Level II Status exists; (iii) 0.125% per annum for any day Level III Status exists; (iv) 0.250% per annum for any day Level IV Status exists; and (v) 0.500% per annum for any day Level V Status exists.

9. GENERAL.

a. Instructions

The Company hereby authorizes the Agent and each Bank to rely upon telephonic, written or facsimile instructions of any person identifying himself or herself as an Authorized Officer and upon any signature which the Agent or such Bank believes to be genuine, and the Company shall be bound thereby in the same manner as if such person were authorized or such signature were genuine. The Company agrees to indemnify the Agent and each Bank from and against all losses and expenses arising out of the Agent's or such Bank's reliance on said instructions or signatures.

b. Payments

Payments hereunder and under the Note shall be made in immediately available funds in Dollars without off-set, counter-claim or other deduction.

c. Costs

The Company shall pay all costs of the Agent with respect to the negotiation, preparation, execution and delivery of this Agreement and the other Loan Documents, any amendments, waivers, consents or modifications with respect thereto and all costs of the Agent and each Bank in connection with the of enforcement or collection of every kind, including but not limited to all reasonable attorneys' fees, court costs and expenses incurred by the Agent or any Bank in connection with collection or protection or enforcement of any rights hereunder whether or not any lawsuit is ever filed.

d. Indemnification

In consideration of the execution and delivery of this Agreement by the Agent and each Bank and the extension of credit hereunder, the Company hereby indemnifies, exonerates and holds the Agent and each Bank and each of its respective officers, directors, employees and agents (collectively, the "Indemnified Parties") free and harmless from and against any and all actions, causes of action, suits, losses, costs, liabilities and damages, and expenses incurred in connection therewith (irrespective of whether such Indemnified Party is a party to the action for which indemnification hereunder is sought), including reasonable attorneys' fees and disbursements (collectively, the "Indemnified Liabilities"), incurred by the Indemnified Parties or any of them as a result of, or arising out of, or relating to any transaction financed or to be financed in whole or in part, directly or indirectly, with the proceeds of any Loan or any investigation, litigation or proceeding related to any environmental cleanup, audit, compliance or other matter relating to the protection of the environment or the release by the Company of any hazardous material, except for any such Indemnified Liabilities arising for the account of a particular Indemnified Party by reason of the relevant Indemnified Party's gross negligence or willful misconduct. If and to the extent that the foregoing undertaking may be unenforceable for

any reason, the Company hereby agrees to make the maximum contribution to the payment in satisfaction of each of the Indemnified Liabilities which is permissible under applicable law.

e. Notices

All notices and other communications provided to any party hereto under this Agreement or any other Loan Document shall be in writing or by facsimile and addressed, delivered or transmitted to such party at its address or facsimile number set forth below its signature hereto or at such other address or facsimile number as may be designated by such party in a notice to the other parties. Any notice, if mailed and properly addressed with postage prepaid shall be deemed given five days after mailed. Any notice sent by courier service shall be deemed given when received. Any notice, if transmitted by facsimile, shall be deemed given when transmitted.

f. Survival

The Obligations of the Company under Sections 2(b), 3(a), 3(e), 3(f), 3(g), 9(c), 9(d) and 10(g) hereof shall survive any payment of the principal of and interest on the Loans and the termination of this Agreement.

g. Counterparts

This Agreement may be executed in any number of separate counterparts, each of which when so executed and delivered shall be an original, and all such counterparts shall together constitute one and the same instrument. Delivery of an executed counterpart via facsimile or other method shall be as effective as delivery of an original executed counterpart.

h. Amendment and Waiver

Any provision of this Agreement or any other Loan Document may be amended or waived if, but only if, such amendment or waiver is in writing and is signed by the Company and the Required Banks (and, if the rights or duties of the Agent are affected thereby, by the Agent); *provided* that no such amendment, waiver or modification shall, unless signed by all the Banks, (i) change the Commitment of any Bank (except for a ratable decrease in the Commitments of all Banks) or subject any Bank to any additional obligation, (ii) reduce the principal of or rate of interest on any Loan or any fees hereunder, (iii) postpone the date fixed for any payment of principal of or interest on any Loan or any fees hereunder or (iv) change the percentage of the Commitments or of the aggregate unpaid principal amount of the Notes, or the number of Banks, which shall be required for the Banks or any of them to take any action under this Section or any other provision of this Agreement. Any waiver by the Agent or any Bank of any rights hereunder or under any other Loan Document shall not constitute a waiver of any other rights of the Agent and the Banks from time to time.

i. JURISDICTION

ANY LITIGATION BASED HEREON, OR ARISING OUT OF, UNDER, OR IN CONNECTION WITH, THIS AGREEMENT OR THE NOTE OR ANY OTHER LOAN DOCUMENT OR ANY COURSE OF CONDUCT, COURSE OF DEALING, STATEMENTS (WHETHER VERBAL OR WRITTEN) OR ACTIONS OF THE AGENT, ANY BANK OR THE COMPANY SHALL BE BROUGHT AND MAINTAINED EXCLUSIVELY IN THE COURTS OF THE STATE OF ILLINOIS OR IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS; PROVIDED, HOWEVER, THAT ANY SUIT SEEKING ENFORCEMENT AGAINST ANY COLLATERAL OR OTHER PROPERTY MAY BE BROUGHT, AT THE AGENT'S OPTION, IN THE COURTS OF ANY JURISDICTION WHERE SUCH COLLATERAL OR OTHER PROPERTY MAY BE FOUND. THE COMPANY HEREBY EXPRESSLY AND IRREVOCABLY SUBMITS TO THE JURISDICTION OF THE COURTS OF THE STATE OF ILLINOIS AND OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS FOR THE PURPOSE OF ANY SUCH LITIGATION AS SET FORTH ABOVE AND IRREVOCABLY CONSENTS TO PERSONAL SERVICE WITHIN OR WITHOUT THE STATE OF ILLINOIS. THE COMPANY HEREBY EXPRESSLY AND IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY LAW, ANY OBJECTION WHICH IT MAY HAVE OR HEREAFTER MAY HAVE TO THE LAYING OF VENUE OF ANY SUCH LITIGATION BROUGHT IN ANY SUCH COURT REFERRED TO ABOVE AND ANY CLAIM THAT ANY SUCH LITIGATION HAS BEEN BROUGHT IN AN INCONVENIENT FORUM. TO THE EXTENT THAT THE COMPANY HAS OR HEREAFTER MAY ACQUIRE ANY IMMUNITY FROM JURISDICTION OF ANY COURT OR FROM ANY LEGAL PROCESS (WHETHER THROUGH SERVICE OR NOTICE, ATTACHMENT PRIOR TO JUDGMENT, ATTACHMENT IN AID OF EXECUTION OR OTHERWISE) WITH RESPECT TO ITSELF OR ITS PROPERTY, THE COMPANY HEREBY IRREVOCABLY WAIVES SUCH IMMUNITY IN RESPECT OF ITS OBLIGATIONS UNDER THIS AGREEMENT, THE NOTE AND EACH OTHER LOAN DOCUMENT.

j. WAIVER OF JURY TRIAL

THE COMPANY, THE AGENT AND THE BANKS WAIVE ANY RIGHT TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING TO ENFORCE OR DEFEND ANY RIGHTS UNDER THIS AGREEMENT, THE NOTE OR ANY OTHER LOAN DOCUMENT, AND THE COMPANY, THE AGENT AND THE BANKS AGREE THAT ANY SUCH ACTION OR PROCEEDING SHALL BE TRIED BEFORE A COURT AND NOT A JURY.

k. Confidentiality

The Company, the Agent and the Banks hereby agree and acknowledge that all information relating to the Company or any subsidiary, which is (i) furnished by the Company to the Agent and the Banks pursuant hereto and (ii) non-public, confidential or proprietary in

nature, shall be kept confidential by the Agent and the Banks in accordance with applicable law, provided that such information and other information relating to the Company and its subsidiaries may be distributed by the Agent and each Bank to the Agent and such Bank's respective directors, officers, employees, attorneys, affiliates, auditors and regulators (and, upon the order of any court or other governmental agency having jurisdiction over the Agent or any Bank, to any other person or entity). The provisions of this Section 9(k) shall survive the termination of this Agreement.

Notwithstanding anything herein to the contrary, confidential "information" shall not include, and the Agent and each Bank may disclose to any and all persons, without limitation of any kind, any information with respect to the U.S. federal income tax treatment and U.S. federal income tax structure of the transactions contemplated hereby and all materials of any kind (including opinions or other tax analyses) that are provided to the Agent or such Bank relating to such tax treatment and tax structure.

l. Applicable Law

This Agreement, the Notes and each other Loan Document shall be governed by the internal laws of the State of Illinois applicable to contracts made and to be performed entirely within such State.

m. Sharing of Set-Offs

Each Bank agrees that if it shall, by exercising any right of set-off or counterclaim or otherwise, receive payment of a proportion of the aggregate amount of principal and interest due with respect to any Note held by it which is greater than the proportion received by any other Bank in respect of the aggregate amount of principal and interest due with respect to any Note held by such other Bank, the Bank receiving such proportionately greater payment shall purchase such participations in the Notes held by the other Banks, and such other adjustments shall be made, as may be required so that all such payments of principal and interest with respect to the Notes held by the Banks shall be shared by the Banks pro rata; *provided* that nothing in this Section shall impair the right of any Bank to exercise any right of set-off or counterclaim it may have and to apply the amount subject to such exercise to the payment of indebtedness of the Company other than its indebtedness under the Notes. The Company agrees, to the fullest extent it may effectively do so under applicable law, that each Bank and any holder of a participation in a Note, whether or not acquired pursuant to the foregoing arrangements, may exercise rights of set-off or counterclaim and other rights under applicable law, and with respect to such holder of such a participation as fully as if such holder of a participation were a direct creditor of the Company in the amount of such participation.

n. Participations

Any Bank may at any time grant to one or more banks or other institutions (each a "*Participant*") participating interests in its Commitment or any or all of its Loans. In the event of any such grant by a Bank of a participating interest to a Participant, whether or not upon notice to the Company and the Agent, such Bank shall remain solely responsible for the performance of its obligations hereunder, and the Company and the Agent shall continue to deal solely and directly with such Bank in connection with such Bank's rights and obligations under this Agreement. Any agreement pursuant to which any Bank may grant such a participating interest shall provide that such Bank shall retain the sole right and responsibility to enforce the obligations of the Company hereunder including, without limitation, the right to approve any amendment, modification or waiver of any provision of this Agreement. The Company agrees that each Participant shall, to the extent provided in its participation agreement, be entitled to the benefits of Section 3 with respect to its participating interest.

o. Assignments

Any Bank may at any time assign to one or more banks or other financial institutions (each an "*Assignee*") all, or a proportionate part of all, of its rights and obligations under this Agreement and the Notes, and such Assignee shall assume such rights and obligations, pursuant to a Joinder Agreement in substantially the form of Exhibit B hereto executed by such Assignee and such transferor Bank, with (and subject to) the subscribed consent of the Company, which shall not be unreasonably withheld, and the Agent, which shall not be unreasonably withheld; *provided* that if an Assignee is an affiliate of such transferor Bank or was a Bank immediately prior to such assignment, no such consent of the Company shall be required; and *provided further* that, if such assignment is in respect of a proportionate part of the transferor Bank's rights and obligations hereunder and under the Notes, the amount of such Bank's Commitment (together with the Commitment of any affiliate of such Bank), after taking into account such assignment, is at least an amount equal to $5,000,000. Upon execution and delivery of such instrument and payment by such Assignee to such transferor Bank of an amount equal to the purchase price agreed between such transferor Bank and such Assignee, such Assignee shall be a Bank party to this Agreement and shall have all the rights and obligations of a Bank with a Commitment as set forth in such instrument of assumption, and the transferor Bank shall be released from its obligations hereunder to a corresponding extent, and no further consent or action by any party shall be required. Upon the consummation of any assignment pursuant to this Subsection 9(o), the transferor Bank, the Agent and the Company shall make appropriate arrangements so that, if required, a new Note is issued to the Assignee. In connection with any such assignment, the transferor Bank shall pay to the Agent an administrative fee for processing such assignment in the amount of $3,500.

p. Federal Reserve Banks

Any Bank may at any time assign all or any portion of its rights under this Agreement and its Note to one or more of the Federal Reserve Banks which comprise the Federal Reserve System. No such assignment shall release the transferor Bank from its obligations hereunder.

q. Identity of Holders

The Agent and the Company may, for all purposes of this Agreement, treat any Bank as the holder of any Note drawn to its order (and owner of the Loans evidenced thereby) until written notice of assignment, participation or other transfer shall have been received by them.

r. Split-Ratings

In the event the Company's S&P Rating and Moody's Rating do not fall within the same Level Status, then (1) if the S&P Rating's Level Status and the Moody's Rating's Level Status are in consecutive Level Status categories, the lower Level Status shall be deemed to apply for purposes of this Agreement or (2) if the S&P Rating's Level Status and the Moody's Rating's Level Status are not in consecutive Level Status categories, then the Level Status immediately above the lower of the S&P Rating's Level Status and the Moody's Rating's Level Status shall be deemed to apply for purposes of this Agreement. For purposes of this Agreement, Level I Status shall be deemed the highest and Level V Status shall be deemed the lowest.

s. Continued Effect; No Novation

Notwithstanding anything contained herein, this Agreement is not intended to and does not serve to effect a novation of the Obligations. Instead, it is the express intention of the parties hereto to reaffirm the indebtedness which is outstanding as of the date hereof created under the Existing Committed Facility Letter which is evidenced by the notes provided for therein.

t. Additional Lenders

The Company may, upon the approval of the Agent, add additional lenders as Banks hereto (each a *"New Bank"*), *provided* that if as a result of the addition of any New Bank the aggregate amount of Commitments then in effect would exceed $200,000,000, the approval of the Required Banks shall also be required prior to adding any such New Bank. Costs incurred by the Agent in connection with adding any New Bank shall be paid by the Company, and the legal documentation pursuant to which any New Bank is added shall be in form and substance reasonably satisfactory to the Agent.

u. Resignation of ABN AMRO

The parties acknowledge that effective as of the date hereof ABN AMRO Bank N.V. is no longer the Agent under the Facility and its Commitment has terminated.

10. THE AGENT.

a. Appointment and Authorization

Each Bank irrevocably appoints and authorizes the Agent to take such action as agent on its behalf and to exercise such powers under this Agreement and the Notes as are delegated to the Agent by the terms hereof or thereof, together with all such powers as are reasonably incidental thereto.

b. Agents Fee

The Company shall pay to the Agent for its own account fees in the amounts and at the times previously agreed upon between the Company and the Agent.

c. Agent and Affiliates

LaSalle Bank National Association shall have the same rights and powers under this Agreement as any other Bank and may exercise or refrain from exercising the same as though it were not the Agent, and LaSalle Bank National Association and its affiliates may accept deposits from, lend money to, and generally engage in any kind of business with the Company or affiliate of the Company as if it were not the Agent hereunder.

d. Action by Agent

The obligations of the Agent hereunder are only those expressly set forth herein. Without limiting the generality of the foregoing, the Agent shall not be required to take any action with respect to any Event of Default, except as expressly provided in Section 7(b). The Agent's duties hereunder and under the other Loan Documents are only those expressly set forth herein and therein and nothing herein or therein shall be deemed to impose on the Agent any fiduciary obligation to any Bank or the Company.

e. Consultation with Experts

The Agent may consult with legal counsel (who may be counsel for the Company), independent public accountants and other experts selected by it and shall not be liable for any action taken or omitted to be taken by it in good faith in accordance with the advice of such counsel, accountants or experts.

f. Liability of Agent

Neither the Agent nor any of its directors, officers, agents, or employees shall be liable to any Bank for any action taken or not taken by it in connection herewith (i) with the consent or at the request of the Required Banks or (ii) in the absence of its own gross negligence or willful misconduct. Neither the Agent nor any of its directors, officers, agents or employees shall be responsible to any Bank for or have any duty to any Bank to ascertain, inquire into or verify (i) any statement, warranty or representation made in connection with this Agreement or any borrowing hereunder; (ii) the performance or observance of any of the covenants or agreements of the Company; (iii) the satisfaction of any condition specified in Article III, except receipt of items required to be delivered to the Agent; (iv) the existence or continuance of an Event of Default; or (iv) the validity, effectiveness or genuineness of this Agreement, the Notes, the other Loan Documents or any other instrument or writing furnished in connection herewith. The Agent shall not incur any liability by acting in reliance upon any notice, consent, certificate, statement, or other writing (which may be a bank wire, telex or similar writing) believed by it in good faith to be genuine or to be signed by the proper party or parties.

g. Indemnification

Each Bank shall, ratably in accordance with its Commitment, indemnify the Agent (to the extent not reimbursed by the Company) against any cost, expense (including counsel fees and disbursements), claim, demand, action, loss or liability (except such as result from the Agent's gross negligence or willful misconduct) that the Agent may suffer or incur in connection with this Agreement or any action taken or omitted by the Agent hereunder.

h. Credit Decision

Each Bank acknowledges that it has, independently and without reliance upon the Agent or any other Bank**,** and based on such documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement. Each Bank also acknowledges that it will, independently and without reliance upon the Agent or any other Bank, and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking any action under this Agreement.

i. Successor Agent

The Agent may resign at any time by giving written notice thereof to the Banks and the Company. Upon any such resignation, the Required Banks shall have the right to appoint a successor Agent, which successor Agent shall be satisfactory to the Company. If no successor Agent shall have been so appointed by the Required Banks, and shall have accepted such appointment, within 30 days after the retiring Agent gives notice of resignation, then the retiring Agent may, on behalf of the Banks, appoint a successor Agent, which shall be a commercial

bank organized or licensed under the laws of the United States of America or of any State thereof and having a combined capital and surplus of at least $100,000,000 and shall otherwise be subject to the consent of the Company, which consent shall not be unreasonably withheld. Upon the acceptance of its appointment as Agent hereunder by a successor Agent, such successor Agent shall thereupon succeed to and become vested with all the rights and duties of the retiring Agent, and the retiring Agent shall be discharged from its duties and obligations hereunder. After any retiring Agent's resignation hereunder as Agent, the provisions of this Article shall inure to its benefit as to any actions taken or omitted to be taken by it while it was Agent.

Please acknowledge your agreement to the foregoing by signing and returning a copy of this letter.

Commitment: $35,000,000

LASALLE BANK NATIONAL ASSOCIATION, individually as a Bank and as Agent.

By: /s/ Denis J. Campbell
Denis J. Campbell

Title: Senior Vice President

By: /s/ Matthew D. Rodgers
Matthew D. Rodgers

Title: Loan Officer

Address: LaSalle Bank National Association
Syndications Unit
135 South LaSalle Street, Suite 1425
Chicago, Illinois 60603
Attention: Damatria Gilbert
Facsimile: (312) 904-4448
Telephone: (312) 904-8277

With copies to:

LaSalle Bank National Association
135 South LaSalle Street
Chicago, Illinois 60603
Attention: Chip Campbell
Facsimile: (312) 904-1994
Telephone: (312) 904-4497

Commitment: $25,000,000

U.S. BANK NATIONAL ASSOCIATION

By: /s/ Andrew Gaspard
Name: Andrew Gaspard
Title: Assistant Vice President

Commitment: $25,000,000

WELLS FARGO BANK,
NATIONAL ASSOCIATION

By: /s/ Mark Halldorson
Name: Mark H. Halldorson
Title: Vice President

By: /s/ Douglas A. Lindstrom
Name: Douglas A. Lindstrom
Title: Vice President
Wells Fargo Bank, National Association

Commitment: $35,000,000

SUNTRUST BANK

By: /s/ Mary B. Smith
Name: MARY B. SMITH
Title: DIRECTOR

Commitment: $35,000,000

BANK ONE

By: /s/ Jane Bek Keil
Name: Jane Bek Keil
Title: Director

Commitment: $20,000,000

THE BANK OF TOKYO - MITSUBISHI, LTD.,
CHICAGO BRANCH

By: /s/ Patrick McCue
Name: Patrick McCue
Title: Vice President & Manager

Agreed to this 23rd day of December, 2003

ALLETE, INC.

By: /s/ James K. Vizanko

Title: _____

Address: 30 West Superior Street
Duluth, Minnesota 55802
Attention: Corporate Treasurer

Facsimile No.: (218) 723-3912

Exhibit 10(t)2

AMENDMENT TO THE
ALLETE EXECUTIVE ANNUAL INCENTIVE PLAN

The ALLETE Executive Annual Incentive Plan (the "Plan") dated January 1, 1999, is amended as follows:

A new Article 20 is added to provide as follows:

20. Amendment. The Company reserves the right to cancel, amend, terminate, suspend or otherwise change the Plan or outstanding Awards for any reason at any time before, during or after the Performance Year to which an Award relates, upon authorization of its Board of Directors. The Executive Compensation Committee of the Board of Directors may expand, reduce or otherwise change any and all opportunities, Awards, and any and all financial factors, or financial measures used in the Plan or outstanding Awards for any reason at any time before, during or after the Performance Year to which an Award relates. All changes described in this paragraph are at the sole discretion of the Board of Directors and/or the Executive Compensation Committee, may be made at any time, and may have a retroactive effective date.

ALLETE, Inc.,

By: /s/ Philip R. Halverson
Philip R. Halverson
Vice President, General Counsel
and Secretary

Exhibit 10(u)

ALLETE AND AFFILIATED COMPANIES

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

(As Amended and Restated
Effective January 1, 2004)

TABLE OF CONTENTS

ALLETE AND AFFILIATED COMPANIES

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

(As Amended and Restated

Effective January 1, 2004)

SECTION 1. ESTABLISHMENT AND PURPOSE

1.1 Establishment of Plan

ALLETE, Inc., formerly MINNESOTA POWER & LIGHT COMPANY (the "Company" and also sometimes "ALLETE") established, effective as of July 1, 1980, a Supplemental Retirement Plan for eligible executives of the Company, such Plan to be known as the SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (THE "PLAN"). The Plan was established in order to provide supplemental current or retirement benefits payable as provided hereafter solely from the general assets of the Company. The Plan is intended to be exempt from the participation, vesting, funding, and fiduciary requirements of Title 1 of the Employee Retirement Income Security Act of 1974.

Effective as of January 1, 1981, the Plan was amended to include compensation attributable to the Company's Incentive Compensation Plan in determining benefits under this Plan.

Effective as of January 1, 1982, the Plan was amended to change the manner in which Incentive Awards are accounted for when determining benefits payable at retirement under Section 4.6.

Effective December 1, 1982, the Plan was amended to change the deferral and cash payment options of the Plan.

The Plan was amended including revisions through and including May 10, 1983, and restated in its entirety as of January 1, 1983. The revisions included a provision to provide benefits that are above the limitations under Section 415 of the Internal Revenue Code.

Effective January 1, 1984, the Plan was amended to provide for a predetermined interest rate of 10.5% to be used in determining the value of certain benefits under the Plan.

Effective January 1, 1987, the Plan was amended to provide for two additional investment choices for monies deferred under the Plan and to make other minor changes to the Plan.

Effective August 1, 1987, the Plan has been amended to provide for a fixed rate of return of 8% under Section 4.15 for deferral elections made after that date rather than a return that is the greater of 10.5% or the Company's actual overall percentage return on capital, and to make a minor change in the Plan name.

Effective May 1, 1988, the Plan was amended so that benefits under Subsections 4.1(c) and (d) of the 1988 Plan document are available only to active Participants who were age 60 or older as of said date.

Effective November 1, 1988, the Plan has been amended to make revisions in certain discretions available to the Company and to eligible Participants.

Effective January 1, 1990, the Plan has been amended to remove Participant choice with respect to the payment of benefits under Subsection 4.1(b). The Plan has also been amended to eliminate the makeup of the 2% CORE benefits, which were eliminated under the Supplemental Retirement Plan (SRP) to account for the Employee Stock Ownership Plan (ESOP), and to provide for a makeup of the Employee Stock Ownership Plan Partnership account allocation contribution. The Plan was also amended to eliminate the benefits previously described in Subsections 4.1(c) and (d) of the 1988 legal plan document.

Effective August 1, 1992, the Plan was amended to change the date Retirement Benefits are due and payable from the last day of the month to the first day of the month.

Effective March 1, 1994, the Plan was amended to calculate the monthly benefit provided under Section 4.6 using a final average earnings calculation which combines Results Sharing with Incentive Compensation.

Effective August 1, 1994, the Plan was amended at Section 3.1 to eliminate the eligibility option of annual compensation in excess of $100,000, to increase voluntary deferrals, to

provide for a present value calculation at Subsection 4.1(d), to change options for measuring indexes for monies deferred under the Plan, and to make other minor administrative changes.

Effective January 1, 1995, the Plan was amended to suspend benefit payments when a Participant is re-employed by the Company in a regular, full-time position.

Effective January 1, 1997, the Plan was amended to allow for Participants to change the duration of the distribution period.

Effective June 17, 1997, the Plan was amended to credit accounts during distribution of benefits with the Company's return on capital fixed rate of 8%.

Effective July 1, 1998, the Plan was amended to combine deferred amounts into a single Executive Deferral Account.

Effective January 1, 1999, the Plan was amended to allow participation by those employees who receive a management salary.

Effective January 1, 2001, the Plan was amended to provide that the Executive Deferral Account be distributed pursuant to the Participant's election in the event of death, to distribute account balances of less than $10,000 in a lump sum, and to change the name of the Plan to the ALLETE Supplemental Executive Retirement Plan.

Effective January 1, 2002 the Plan was amended to allow the choice of a life or joint and survivor annuity for Retirement Benefits, to eliminate deferrals which exceeded limitations imposed by Code Section 415, to allow unscheduled in-service withdrawals, to remove the limitation on deferrals of annual salary, and to provide a supplemental tax benefit for participants in the event that they are terminated due to a change in control, and to reflect the merger of the Supplemental Retirement Plan and the Employee Stock Ownership Plan into the Retirement Savings and Stock Ownership Plan.

Effective January 20, 2003, deferrals of stock option gains were eliminated.

Effective December 1, 2003, the termination of a Participant is clarified to include the sale of a Participant's employer, but not the separation of a Participant's employer from the Company through a stock dividend.

1.2 Purpose of the Plan

It is the purpose of this Plan to provide eligible executives with benefits that will compensate them for limitations which apply to the Minnesota Power and Affiliated Companies Flexible Compensation Plan, Minnesota Power and Affiliated Companies Retirement Savings and Stock Ownership Plan (sometimes hereinafter the "Retirement Savings and Stock Ownership Plan" or "RSOP"), Minnesota Power and Affiliated Companies Retirement Plan A and to provide a benefit which includes compensation attributable to the ALLETE Executive Annual Incentive Plan (sometimes hereinafter the "Annual Incentive Plan") and Other Awards as though such awards were eligible for benefit plans which are qualified under Section 401(a) and (k) of the Code. The Plan also provides for deferral of salary and annual and long-term incentive compensation awards.

SECTION 2. DEFINITIONS

2.1 Definitions

Whenever used in the Plan, the following terms shall have the respective meanings set forth below, unless otherwise expressly provided herein, and when the defined meaning is intended, the term is capitalized:

(A) **"Annual Incentive Award"** means the annual award received by a Participant under the ALLETE Executive Annual Incentive Plan or any predecessor plan.

(B) **"Change in Control"** means change of control of ALLETE, Inc. as defined in the ALLETE Executive Long Term Incentive Compensation Plan.

(C) **"Committee"** means the committee with authority to administer the Plan as provided under Section 5.1.

(D) **"Company"** means ALLETE, Inc., and any other affiliated company which adopts this Plan by action of its Board of Directors and is consented to by the Compensation Committee of the ALLETE Board of Directors. A list of such companies shall be maintained by ALLETE.

(E) **"Compensation"** means the Participant's earnings during a calendar year, before any reduction pursuant to Code Sections 125, 132(f)(4), or 401(k). It does not include overtime compensation, if any, bonuses, Annual Incentive Awards and Other Awards, expenses, allowances, commission payments (except when regular compensation consists wholly or in part of commissions, in which case commission payments are included), employer contributions or awards under this Plan or other employee benefit plans, imputed income (whether such imputed income is from vehicle use, life insurance premiums, or any other source) payments made pursuant to the Results Sharing Program, payment of stock options and performance shares under the Long Term Incentive Compensation Plan, and any other payments of a similar nature. In the case of a Participant who is employed jointly by the Company and an affiliated company (as defined in the RSOP), Compensation as defined herein shall include amounts received from all such companies.

(F) "**Deferred Stock Unit**" means the units credited to a Participant which correspond to the number of shares the Participant deferred in accordance with Section 4.5.

(G) **"Eligible Surviving Spouse"** means surviving spouse as defined in the Company's Retirement Plan A.

(H) **"Executive Deferral Account" or "EDA" or "Account"** means the account where deferrals pursuant to Sections 4.1, 4.2, 4.3, 4.4 and 4.5 are credited.

(I) **"Other Award"** means an annual award received by the Participant as approved by the Committee and which is not the Annual Incentive Award described in Subsection 2.1(A), and does not include a severance benefit.

(J) **"Pay"** means the annual salary as of October 1 of the year prior to the year for which the allocation is attributed to under Section 4.1 of this Plan.

(K) **"Participant"** is defined in Section 3.

(L) **"Retire" or "Retirement"** means a Participant's termination of employment after attaining "Early Retirement Age" or "Normal Retirement Age" defined as the earliest date under any qualified retirement plan of the Participant's employer.

(M) **"Retirement Benefit"** means the benefit payable to a Participant pursuant to the Plan by reason of the Participant's Retirement with the Company described in Section 4.6.

(N) **"Retirement Plan A"** means the Minnesota Power and Affiliated Companies Retirement Plan A.

(O) **"Retirement Savings and Stock Ownership Plan" or "RSOP"** means the Minnesota Power and Affiliated Companies Retirement Savings and Stock Ownership Plan.

(P) **"Stock Option Gain Shares Deferral Election"** means the annual election made by the Participant in accordance with Section 4.5.

(Q) **"Supplemental Salary Reduction Agreement"** means an agreement entered into by a Participant and the Company in December of a fiscal year under which the Participant irrevocably agrees to forego compensation that would otherwise be paid to the Participant during the next fiscal year.

(R) **"Valuation Date"** means each date on which the Accounts are valued as provided in Subsection 4.7(C).

2.2 Gender and Number

Except when otherwise indicated by the context, any masculine terminology used herein shall also include the feminine, and the use of any term herein in the singular may also include the plural.

SECTION 3. ELIGIBILITY AND PARTICIPATION

3.1 Eligibility

Any employee of the Company shall become a Participant as follows:

(A) For benefits under Section 4.1, 4.2, 4.3 and 4.4, an employee in management salary grade or other employees as approved by the Committee, who participates in the ALLETE Executive Annual Incentive Plan or is eligible to receive an Other Award, shall be eligible to participate in this Plan beginning with the first calendar year in which such employee becomes eligible to receive Annual Incentive Awards or Other Awards.

The following conditions must also be satisfied:

i. The Participant is in the employment of the Company on the last day of the calendar year;

ii. The Participant died while employed by the Company during such calendar year;

iii. The Participant Retired during such calendar year;

iv. The Participant is disabled and is receiving benefit payments under the Company's Long-Term Disability Benefit Plan during such calendar year; or

v. The Participant was on leave of absence at the close of such calendar year and received Compensation from the Company during such year.

(B) For benefits under Section 4.5, senior executive employees are eligible as approved by the Company's Board of Directors. Effective January 20, 2003, no additional employees are eligible for the benefits provided under Section 4.5.

(C) For benefits under Section 4.6, employees who received an Annual Incentive Award or Other Awards while in ALLETE management salary grades SA – SM.

3.2 Participation

An employee who becomes a Participant shall remain eligible to have an account in the Plan as a Participant hereunder, without regard to Compensation and Annual Incentive Awards or Other Awards received in subsequent years, until the last to occur of (i) the employee's Retirement or termination from service for any reason or (ii) the date all benefits, if any, to which he or she is entitled hereunder have been distributed. Employees, who were former Participants, who become employed by an ALLETE wholly or partially owned company, shall not be considered as retired or terminated until such time as they become retired or terminated from the new company. If a Participant is employed by a subsidiary of the Company, and such subsidiary is no longer at least 50% owned by the Company, then such Participant will be considered to be terminated or Retired (as defined in Section 2.1(L)) on such date. Distribution of the Participant's benefits under Sections 4.9, 4.10 or 4.13 shall occur as provided therein. Notwithstanding the preceding sentence of this Paragraph, in the event that a Participant is employed by a subisidary of the Company which is distributed to shareholders through a stock spin off to shareholders of ALLETE, then the Participant will not be considered to be terminated or Retired (as defined in Section 2.1(L)) for purposes of Section 4.9, 4.10 or 4.13 until their employment at such distributed company terminates for any reason, including Retirement. For purposes of Section 4.6, the Participant will be considered Retired (as set forth in Section 2.1(L)) if the Participant continues employment at such distributed company until the Participant's 50th birthday. Any employment period, salary or other amount earned while employed at such distributed company, however, will not be included in the calculation of the benefit provided under Section 4.6.

An employee who was a Participant, but is not currently eligible for benefits under Sections 4.1, 4.2, 4.3, 4.4, and 4.5, will not receive account additions as described herein. However, the employee may be eligible for benefits under Section 4.6 if they qualify under the terms provided in that Section.

An employee who is a Participant who dies prior to Retirement is no longer entitled to the benefit described under Section 4.6.

3.3 No Guarantee of Employment

Participation in the Plan does not constitute a guarantee or contract of employment with the Company. Such participation shall in no way interfere with any rights the Company would have in the absence of such participation to determine the duration of the employee's employment with the Company.

SECTION 4. BENEFITS

4.1 Annual Makeup Award

For each calendar year ending on or after December 31, 1980, and except as hereinafter specifically provided in this Section 4, the Company shall credit each Participant who qualifies:

(A) **Flexible Dollar Makeup.** An amount equal to the sum of (a) 2% plus (b) the Participant's life insurance percentage under the Minnesota Power and Affiliated Companies Flexible Compensation Program for nonunion employees, multiplied by the following: (i) the total of the Participant's Annual Incentive Award and Other Awards for such year, plus (ii) any amount of the Participant's annual Pay not included in calculating benefits under the Minnesota Power and Affiliated Companies Flexible Compensation Program for nonunion employees for such year due to limitations under Internal Revenue Service (IRS) Code Section 404(l).

(B) **RSOP Allocation Makeup.** An amount equal to the applicable Partnership allocation percent being contributed under Section 4.4(c) of the RSOP of the following:

(a) the total of the Participant's Annual Incentive Award and Other Award for such year, plus

(b) the amount of the Participant's Compensation not included in calculating benefits under the RSOP due to limitations under IRS Code Section 404(l).

If a Participant transfers to an ineligible status, dies or Retires during the year, this calculation will be based on the full Annual Incentive Award and Other Award. If a Participant's annual Pay exceeds that amount allowed under IRS qualified plan's compensation limit, the amount of Participant's annual Pay will be prorated for the number of months in an eligible status.

(C) **RSOP Match Allocation Makeup**. An amount equal to 50% of the amount deferred by the Participant under Section 4.2 of this Plan plus any amount deferred under Section 5.1 of the RSOP, provided, however, that for any calendar year, such match shall not apply to any amount deferred by a Participant in excess of the amount specified in Subsection 4.4(e) of the RSOP of the Participant's Compensation plus Annual Incentive Award and Other Award. Such amount shall be reduced by any amount being contributed by the Company under Subsection 4.4(e) of the RSOP.

4.2 Salary Deferral

Effective through December 31, 2002, the Company shall credit each Participant who qualifies an amount equal to the amount for which a Participant has elected to reduce his or her annual salary pursuant to a Supplemental Salary Reduction Agreement, not to exceed 25% of the Participant's annual salary less the amount allowable to be deferred under the RSOP. Effective January 1, 2003, the Company shall credit each Participant who qualifies an amount equal to the amount for which a Participant has elected to reduce his or her annual salary pursuant to a Supplemental Salary Reduction Agreement.

4.3 Bonus Deferral

The Company shall credit each Participant who qualifies an amount equal to the amount for which a Participant has elected to defer his or her Annual Incentive Award or Other Award.

4.4 Severance Deferral

The Company shall credit each Participant who qualifies an amount equal to the amount for which a Participant has elected to defer his or her severance benefit as approved for deferral by the Committee.

4.5 Non-Qualified Stock Option Gain Deferral

Effective July 1, 1999 through January 20, 2003, the Company shall credit each Participant who qualifies an amount, equal to the amount for which a Participant has elected to defer receipt of his or her shares of ALLETE stock acquired through an Ownership Retention Option Program provided in the Long Term Incentive Compensation Plan and pursuant to the Stock Option Gain Shares Deferral Election.

4.6 Retirement Benefit

At the Retirement of a Participant, the Company shall credit each Participant who qualifies under Subsection 3.1(C) with a Retirement Benefit. The Retirement Benefit shall be calculated as follows:

(A) The monthly Retirement Benefit that would be provided by Retirement Plan A if:

(1) any annual salary limitation in calculating benefits under Retirement Plan A due to the limitation imposed by any provision of the Code Section 404(l) did not exist, and the limitation on annual benefits contained in Code Section 415 did not exist.

(2) Effective through December 31, 2003, the largest sum of four Annual Incentive Awards and Other Awards plus Results Sharing (if any) during any consecutive 48-month period in the most recent 15-year period had been added to the final average earning calculation in Subsection 2.1(q) of Retirement Plan A and such calculation was then reduced by any Results Sharing and Other Awards included in the calculation of final average earnings in Subsection 2.1(q) of Retirement Plan A. The periods covering final average earnings and the four consecutive Annual Incentive Awards and Other Awards plus Results Sharing need not cover the same 48-month period.

Effective January 1, 2004, the largest sum of four Annual Incentive Awards or Other Awards (if any) during any consecutive 48-month period in the most recent 15-year period had been added to the total of the final average

earning computation in Subsection 2.1(q) of Retirement Plan A. The periods covering final average earnings and the four consecutive Annual Incentive Awards and/or Other Awards need not cover the same 48-month period. Notwithstanding the foregoing, any Other Award(s) included in Retirement Plan A final average earnings, shall be reduced from the amount herein.

(B) Less the actual monthly retirement benefit provided by Retirement Plan A.

(C) To determine the amount to be credited to the Participants, the resulting difference of (A) less (B) (provided the difference is greater than zero) is multiplied by 12, and the result is multiplied by a factor. Such factor is calculated by first determining a 60% joint and survivor benefit using the respective employee and spouse ages; second, by adjusting for cost of living as described in Section 4.8 of Retirement Plan A and each of the components is multiplied by 50% and the results are added together. The change in the consumer price index shall be assumed to change after the Participant's Retirement at the same average annual rate as the change in the consumer price index for the five-year period ending on the later of the June 30 or the December 31 immediately preceding Retirement. The interest rate to be used in determining the present value and the monthly annuity shall be an annual percentage rate of 8% or such other rate as determined by the Committee.

4.7 Benefit Allocations and Maintenance of Accounts

(A) The amounts specified in Sections 4.1 and 4.3 shall be allocated to the Participant as soon as administratively practicable after the end of the Plan Year.

(B) The amounts specified in Sections 4.2, 4.4 and 4.5 shall be allocated as soon as administratively practicable, but no later than the month following the end of the month in which the benefit was earned by the Participant.

(C) The Company shall establish and maintain, in the name of each Participant, an individual account to be known as the Executive Deferral Account (herein referred to as "EDA" or "Account"). The Committee shall determine the investment funds

(known as Investment Funds) available under the Plan and may add or delete Investment Funds from time to time. Account contributions under Sections 4.1, 4.2, 4.3, and 4.4 may be credited in the same manner as if actually invested in the manner identified by the Participant's election among Investment Funds as directed by the Participant. Account additions under Section 4.5 shall be credited to the Participant's Deferred Stock Unit account within the EDA.

As of each Valuation Date, each Account shall be adjusted to reflect the effect of investment gains or losses, income contributions, distributions, transfers and all other transactions with respect to that Account since the previous Valuation Date.

(D) The Account of each Participant shall be entered on the books of the Company and shall represent a liability, payable when due under this Plan, out of the general assets of the Company. Prior to benefits becoming due hereunder, the Company shall expense the liability for payment of such accounts in accordance with policies determined appropriate by the Company's auditors.

4.8 Date of Benefit Commencement

(A) Executive Deferal Account Election

(1) All amounts credited to a Participant's Account under Section 4.1, 4.2, 4.3, 4.4, and Deferred Stock Units under Section 4.5, shall be distributed pursuant to an election submitted by the Participant. Elections under this 4.8 must be made in writing to the Committee prior to the end of the calendar year preceding the year in which benefits are earned. Participants who become eligible during the Plan Year shall make their election upon becoming eligible. If no election has been received herein, or the Participant Retires or dies prior to the benefit allocation, the allocation for such Plan Year shall be paid in cash. If a Participant transfers to an ineligible status during the calendar year, any such award specified in Section 4.1 and or 4.3 shall be paid in cash.

Each Participant shall have the right to elect to have all or any portion of the benefit amounts allocated to said Participant for a calendar year paid under one of the following options:

(a) in cash (either partially or totally);

(b) deferred to a date specified by the Participant (at which time such benefit amounts shall be paid as a lump sum, with the latest deferral date to be no later than April 1 following a Participant attaining age 70 ½); or

(c) deferred to the earlier to occur of the following events:

(i) Retirement or at the time when a disabled Participant is no longer eligible to receive benefits under the applicable employer's long-term disability benefit plan or, if elected, up to five years after Retirement but in no event later than April 1 following a Participant attaining age 70 ½.

(ii) Death of the Participant.

(iii) Termination of the Participant's employment other than at Retirement or long-term disability.

(B) Commencement of Retirement Benefits.

Pursuant to Section 4.6, this benefit shall commence on the last day of the month following the date of the Participant's Retirement. If a Participant dies or terminates employment prior to Retirement, the Retirement Benefit described in Section 4.6 shall be forfeited and will not be payable.

4.9 Form of Benefit Payment - Executive Deferral Account

Subject to the provisions of Sections 4.11, 4.12 and 4.13 hereof, and in accordance with Subsection 4.8(A)(1)(c), a Participant may elect distribution of the Executive Deferral Account as a lump sum, five (5), ten (10), or fifteen (15) year monthly annuity, or partial lump sum with the remainder paid in a five (5), ten (10), fifteen (15) year monthly annuity. Deferred Stock Units shall be distributed in equal annual installments, during the elected payout period. If a Participant has not elected a payout period, the balance will be paid in a lump sum. The Participant may change the length of the payment period, if such

change is received by the Committee more than 12 months prior to commencement of the payment period. Notwithstanding the above, if the sum of Sections 4.1, 4.2, 4.3, 4.4 and 4.5 is less than $10,000, the EDA is paid as a lump sum.

EDA distributions (except Deferred Stock Units) will be paid in cash, in equal monthly installments commencing on the last day of the month pursuant to Participants election in Subsection 4.8(A)(1)(c), except that Deferred Stock Units will be distributed in shares of stock commencing within the first 60 days of the Plan Year pursuant to the Participant's election in Subsection 4.8(A)(1)(c).

If a Participant has commenced receipt of benefits under this Plan, and is re-employed by the Company, payments shall be suspended until the Participant again becomes eligible to receive payments under the Plan.

4.10 Form of Payment - Retirement Benefits

The Participant may elect to receive the Retirement Benefits provided for in Section 4.6 in the form of (A) or (B) below:

(A) 15-year monthly annuity (calculated using an 8% interest rate or other rate as approved by the Committee)

(B) Monthly life annuity (calculated using the factor described under Section 4.6). Such amount to be adjusted (i.e. cost of living adjustment) in accordance with Retirement Plan A Section 4.8.

If the actuarial present value of the benefit under Section 4.6 is less than $10,000, the benefit will be paid out in a lump sum payment.

If a Participant has commenced receipt of benefits under this Plan, and is re-employed by the Company, payments shall be suspended until the Participant again becomes eligible to receive payments under the Plan.

4.11 Benefit Payments Upon Participant's Death

Each Participant may designate, by letter to the Committee, a beneficiary to receive any payment to be made hereunder after the death of the Participant. The designation shall take effect upon receipt of the letter by the Committee. A Participant may change his or her designated beneficiary or beneficiaries from time to time and each such letter of designation shall revoke any previous designation. If no beneficiary has been designated, or if all designated beneficiaries have predeceased the Participant, the deceased Participant's estate shall be the Participant's beneficiary. If a designated beneficiary shall survive the Participant but all designated beneficiaries shall die prior to complete distribution of the benefit payable with respect to the Participant, the deceased Participant's beneficiary shall be the estate of the last surviving designated beneficiary.

The benefits shall be paid under the circumstances as described in (a) or (b) below:

(a) If the designated beneficiary is the Eligible Surviving Spouse, the payment as elected by the Participant pursuant to Section 4.9 & 4.10 will be paid to the beneficiary beginning the month following the date of death of the Participant, except if the benefit elected under Section 4.10 is a life annuity, the surviving spouse will receive 60% of the Participant's life annuity benefit for the remainder of the beneficiary's life. If the Participant has elected a distribution to commence prior to Retirement, the Company shall pay the remaining payments to the Participant's beneficiary in the same manner and at the same time as if the Participant had lived to receive such payments, subject to the conditions set forth in this Section.

(b) If the designated beneficiary is anyone other than the Eligible Surviving Spouse, the remaining benefit payments shall be paid in a lump sum in the month following the month of the Participant's death, except if the benefit elected under Section 4.10 is a life annuity, the payments end.

In the event a Participant dies prior to Retirement, the benefit described in Section 4.6 shall be forfeited and will not be payable.

4.12 Benefit Payment Upon Disability

In the event a Participant is determined to be disabled under the Company's Long Term Disability Plan, the Participant shall continue to be eligible for this Plan during such period of disability. If the Participant ceases to be disabled prior to Retirement and does not return to active employment with the Company, the Participant shall be deemed to have terminated employment. The Company shall pay the Participant the balance credited to the Participant's EDA account in a single lump sum the month following the month of such termination.

4.13 Benefit Payments Upon Termination Other Than Retirement, Death or Disability

If a Participant's employment with the Company terminates for any reason other than Retirement, death or disability, the Company shall pay each Participant the balance credited to the Participant's EDA account in a single lump sum no later than the month following the month in which the Participant terminates, without regard to any election made by the Participant under Section 4.8. The benefit described in Section 4.6 shall be forfeited and will not be payable.

4.14 Hardship and Unscheduled Benefit Payments

(A) A Participant who has demonstrated a severe financial need as approved by the Committee may request a lump sum distribution of all or any portion of their EDA. Partial distributions will be taken pro rata from the Participant's EDA sub-accounts. However, if a Participant has commenced payment of benefits, the hardship distribution will be the entire remaining balance.

(B) A Participant may elect at any time prior to the time that the first payment from his or her account would otherwise be paid, to withdraw in a single lump sum all, or a specified portion of the balance of his or her Executive Deferral Account. A Participant may also make an election at any time subsequent to the start of installment payments from his or her Executive Deferral Account. Withdrawals under this Section will be reduced in amount by an early withdrawal penalty equal to ten percent of the amount requested, which will be deducted from the amount paid to the Participant and forfeited by the Participant to the Company. Written notice of election to withdraw under this Section stating the lump sum amount

withdrawn shall be sent to the Company, and payment of the early withdrawal shall be made by the Company within thirty days of receipt of written notice.

4.15 Supplemental Tax Benefit

In the event that there is a Change in Control of the Company, and if, within twelve (12) months after a Change in Control a Participant is involuntarily terminated, the Participant shall be entitled to an additional benefit equal to forty percent (40%) of the amount distributed ("Supplemental Tax Benefit") pursuant to Section 4.13, if any. If a Participant is eligible for Retirement, no Supplemental Tax Benefit will be paid.

SECTION 5. ADMINISTRATION

5.1 Committee

This Plan shall be administered by the committee appointed by the Board of Directors of the Company and known as the Employees' Benefit Plans Committee (the "Committee").

The interpretation and construction by the Committee of any provisions of the Plan shall be final unless otherwise determined by the Board of Directors. Subject to the Board, the Committee is authorized to interpret the Plan, to prescribe, amend and rescind rules and regulations relating to it, and to make all other determinations necessary for its administration.

Without limiting the generality of the foregoing, the Committee shall have the authority to calculate amounts allocable to Participants, to maintain and adjust accounts, and to calculate the percentage net return on account balances.

5.2 Uniform Rules

In administering the Plan, the Committee will apply uniform rules to all Participants similarly situated.

5.3 Notice of Address

Any payment to a Participant or beneficiary, at the last known post office address on file with the Company, shall constitute a complete acquittance and discharge to the Company and any director or officer with respect thereto unless the Company shall have received prior written notice of any change in the address, condition, or status of the distributee. Neither the Company nor any director or officer shall have any duty or obligation to search for or ascertain the whereabouts of any Participant or his beneficiary.

5.4 Records

The records of the Committee with respect to the Plan shall be conclusive on all Participants, all beneficiaries, and all other persons whomsoever.

5.5 Correction of Errors

It is recognized that in the operation and administration of the Plan, certain mathematical and accounting errors may be made or mistakes may arise by reason of factual errors in information supplied to the Company. The Company shall have power to cause such equitable adjustments to be made to correct for such errors as the Company in its discretion considers appropriate. Such adjustments shall be final and binding on all persons.

5.6 Claims Procedure

If any claim for benefits under the Plan is wholly or partially denied, the claimant shall be given notice in writing, within a reasonable period of time after receipt of the claim by the Plan, by registered or certified mail, of such denial, written in a manner calculated to be understood by the claimant, setting forth the specific reasons for such denial, specific reference to pertinent Plan provisions on which the denial is based, a description of any additional material or information necessary for the claimant to perfect the claim and an explanation of why such material or information is necessary, and an explanation of the Plan's claim review procedure. The claimant also shall be advised that he or his duly authorized representative may request a review by the Committee of the decision denying the claim by filing with the Committee, within 60 days after such notice has been received by the claimant, a written request for such review, and that the claimant may review

pertinent documents, and submit issues and comments in writing within the same 60-day period. If such request is so filed, such review shall be made by the Committee within 60 days after receipt of such request, and the claimant shall be given written notice of the decision resulting from such review, and shall include specific reasons for the decision, written in a manner calculated to be understood by the claimant, and specific references to the pertinent Plan provisions on which the decision is based.

5.7 Change of Law

The Committee may make payments of any benefits or deferred amounts to be paid under the Plan, to any Participant or Participants, or to the beneficiary of any Participant or Participants, in advance of the date when otherwise due, (i) if, based on a change in federal tax law or regulation, published rulings or similar announcements by the Internal Revenue Service, decision by a court of competent jurisdiction involving the Plan, a Participant or a beneficiary, or a closing agreement made under Section 7121 of the Internal Revenue Code of 1986 that involves the Plan, a Participant or a beneficiary, it determines that a Participant or beneficiary will recognize income for federal income tax purposes with respect to amounts that are otherwise not then payable under the Plan; or (ii) if it shall be determined that the Plan is subject to the requirements of Parts 2 and 3 of Subtitle B of Title I of the Employee Retirement Income Security Act of 1974, because such Plan is not maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.

5.8 Tax Withholding

The Company shall have the right to deduct from all payments to be made under the Plan, any federal, state or local taxes or other charges required by law to be withheld with respect to such payments.

5.9 Generation-Skipping Tax

Notwithstanding any provisions in this Plan to the contrary, the Committee may withhold any benefits payable to a beneficiary as a result of the death of the Participant (or the death of any beneficiary designated by the Participant) until such time as (i) the Committee is able to determine whether a generation-skipping transfer tax, as defined in Chapter 13 of the Internal Revenue Code of 1986, or any substitute provision therefor, is

payable by the Company; and (ii) the Committee has determined the amount of generation-skipping transfer tax that is due, including interest thereon. If any such tax is payable, the Committee shall reduce the benefits otherwise payable hereunder to such beneficiary by the amount necessary to provide said beneficiary with a benefit equal to the amounts that would have been payable if the original benefits had been calculated on the basis of a value for the Participant's supplemental account reduced by an amount equal to the generation-skipping transfer tax and any interest thereon that is payable as a result of the death in question. The Committee may also withhold from distribution by further reduction of the then net value of benefits calculated in accordance with the terms of the previous sentence such amounts as the Committee feels are reasonably necessary to pay additional generation-skipping transfer tax and interest thereon from amounts initially calculated to be due. Any amounts so withheld, and not actually paid as a generation-skipping transfer tax or interest thereon, shall be payable as soon as there is a final determination of the applicable generation-skipping tax and interest thereon.

SECTION 6. GENERAL PROVISIONS

6.1 Nonassignability

Benefits under the Plan are not in any way subject to the debts of other obligations of the persons entitled thereto and may not voluntarily or involuntarily be sold, transferred, or assigned.

6.2 Incompetency

Every person receiving or claiming benefits under the Plan shall be conclusively presumed to be mentally competent and of age until the Committee receives written notice, in a form and manner acceptable to it, that such person is incompetent or a minor, and that a guardian, conservator, statutory committee, or other person legally vested with the care of his or her estate has been appointed. In the event that the Committee finds that any person to whom a benefit is payable under the Plan is unable to properly care for his or her affairs, or is a minor, then any payment due (unless a prior claim therefor shall have been made by a duly appointed legal representative) may be paid to the spouse, a child, a parent, a brother or sister, or to any person deemed by the Committee to have incurred expense for such person otherwise entitled to payment.

In the event a guardian or conservator or statutory committee of the estate of any person receiving or claiming benefits under the Plan shall be appointed by a court of competent jurisdiction, payment shall be made to either guardian or conservator or statutory committee provided that proper proof of appointment is furnished in a form and manner suitable to the Committee. Any payment made under the provisions of this Subsection shall be a complete discharge of liability therefor under the Plan.

6.3 Employment Rights

The establishment of the Plan shall not be construed as conferring any legal rights upon any Participant or any other person for a continuation of employment, nor shall it interfere with the rights of the Company to discharge any person and/or treat such person without regard to the effect which such treatment might have upon him or her as a person covered by this Plan.

6.4 No Individual Liability

It is declared to be the express purpose and intention of the Plan that no liability whatever shall attach to or be incurred by the shareholders, officers, or directors of the Company, or any representatives appointed hereunder by the Company, under or by reason of any of the terms or conditions of the Plan.

6.5 Illegality of Particular Provision

If any particular provision of the Plan shall be found to be illegal or unenforceable, such provision shall not affect the other provisions thereof, but the Plan shall be construed in all respects as if such invalid provision were omitted.

6.6 Contractual Obligations

It is intended that the Company is under a contractual obligation to make payments to Participants from the general funds and assets of the Company in accordance with the terms and conditions of the Plan, with such payments to reduce the amounts allocated to the Participant's account hereunder. A Participant shall have no rights to such payments other than as a general, unsecured creditor of the Company.

6.7 Counterparts

This Plan may be executed in any number of counterparts, each of which shall constitute but one and the same instrument and may be sufficiently evidenced by any one counterpart.

6.8 Evidence

Evidence required of anyone under the Plan may be by certificate, affidavit, document or other information which the person relying thereon considers pertinent and reliable, and signed, made or presented by the proper party or parties.

6.9 Action by Company

Any action required of or permitted by the Company under the Plan shall be by resolution of it's Board of Directors or by a person or persons authorized by resolution of the Board to act on its behalf with respect to the Plan.

SECTION 7. AMENDMENT AND TERMINATION

7.1 Amendment and Termination

The Company expects the Plan to be permanent, but since future conditions affecting the Company cannot be anticipated or foreseen, the Company must necessarily and does hereby reserve the right to amend, modify, or terminate the Plan at any time by written resolution of its Board of Directors. Provided, however, no amendment, termination or other change in the Plan shall reduce the amount allocated to the account of a Participant on the date of such amendment, termination or other change, which account balance shall be payable to such Participant or such Participant's beneficiary as provided herein.

7.2 Reorganization of the Company

In the event of a merger or consolidation of the Company, or the transfer of substantially all of the assets of the Company to another corporation, such continuing, resulting or

transferee corporation shall have the right to continue and carry on the Plan and to assume all liabilities of the Company hereunder without obtaining the consent of any Participant or beneficiary. If such successor shall assume the liabilities of the Company hereunder, then the Company shall be relieved of all such liability, and no Participant or beneficiary shall have the right to assert any claim against the Company for benefits under or in connection with this Plan.

SECTION 8. APPLICABLE LAWS

8.1 Applicable Laws.

The Plan shall be governed by and construed according to the laws of the State of Minnesota.

IN WITNESS WHEREOF, ALLETE, Inc., has caused this instrument to be executed by its duly authorized officers and its corporate seal to be hereunto affixed.

ALLETE, Inc.

[CORPORATE SEAL]

By /s/ Donald J. Shippar

Its President and Chief Executive Officer

ATTEST:

By /s/ Philip R. Halverson

Its Vice President, General Counsel & Secretary

AMENDMENT TO THE AMENDED AND RESTATED MINNESOTA POWER AND AFFILIATED COMPANIES EXCUTIVE INVESTMENT PLAN I

The Amended and Restated Minnesota Power and Affiliated Companies Executive Investment Plan I, effective November 1, 1988, is amended as follows:

1. The heading of Section 7 is amended to read "Financial Hardship, Change of Law, and Unscheduled Benefit Payments."

2. Effective April 23, 2003, a new Section 7.3 Unscheduled Benefit Payments is added as follows:

   A Participant may elect at any time prior to the time that the first payment from his or her account would otherwise be paid, to withdraw in a single lump sum all, or a specified portion of the balance of his or her Deferral Account. A Participant may also make an election at any time subsequent to the start of installment payments from his or her account, to withdraw in a lump sum the balance of his or her Deferral Account. Withdrawals under this section will be reduced in amount by an early withdrawal penalty equal to ten percent of the amount requested, which will be deducted from the amount paid to the Participant, and forfeited by the Participant to the Company. Written notice of election to withdraw under this Section stating the lump sum amount withdrawn shall be sent to the Manager, Employee Benefits, Human Resources, and payment of the early withdrawal shall be made by the Company within thirty days of receipt of written notice.

3. Effective December 1, 2003, Section 2.1(aa) is amended to add the following:

If a Participant is employed by a subsidiary of the Company, and such subsidiary is no longer at least 50% owned by the Company, then such Participant will be considered to have a Termination of Employment or Retirement on such date. Distribution of the Participant's benefits under Section 6 shall occur as provided therein. Notwithstanding the preceding sentences of this Paragraph, in the event that a Participant is employed by a subsidiary of the Company which is distributed to shareholders through a stock spin off to shareholders of ALLETE, then the Participant will not be considered to have a Termination of Employment or Retirement for purposes of Section 6 until their employment at such distributed company terminates for any reason, including Retirement.

4. Effective March 18, 2002, Section 6.4.1 is amended to add the following:

In the event that there is a Change in Control, and if, within twelve (12) months after a Change in Control a Participant is involuntarily terminated, the Participant shall be entitled to an additional benefit equal to forty percent (40%) of any amount distributed ("Supplemental Tax Benefit") pursuant to Section 6.4.1. If a Participant is eligible for Retirement, no Supplemental Tax Benefit will be paid.

ALLETE, Inc.

By: /s/ Donald J. Shippar
Donald J. Shippar
President and Chief Executive Officer

Attest: /s/ Philip R. Halverson
Philip R. Halverson
Vice President,
General Counsel & Secretary

AMENDMENT TO THE AMENDED AND RESTATED MINNESOTA POWER AND AFFILIATED COMPANIES EXCUTIVE INVESTMENT PLAN II

The Amended and Restated Minnesota Power and Affiliated Companies Executive Investment Plan II, effective November 1, 1988, is amended as follows:

1. The heading of Section 7 is amended to read "Financial Hardship, Change of Law, and Unscheduled Benefit Payments."

2. Effective April 23, 2003, a new Section 7.3 Unscheduled Benefit Payments is added as follows:

   A Participant may elect at any time prior to the time that the first payment from his or her account would otherwise be paid, to withdraw in a single lump sum all, or a specified portion of the balance of his or her Deferral Account. A Participant may also make an election at any time subsequent to the start of installment payments from his or her account, to withdraw in a lump sum the balance of his or her Deferral Account. Withdrawals under this section will be reduced in amount by an early withdrawal penalty equal to ten percent of the amount requested, which will be deducted from the amount paid to the Participant, and forfeited by the Participant to the Company. Written notice of election to withdraw under this Section stating the lump sum amount withdrawn shall be sent to the Manager, Employee Benefits, Human Resources, and payment of the early withdrawal shall be made by the Company within thirty days of receipt of written notice.

3. Effective December 1, 2003, Section 2.1(aa) is amended to add the following:

If a Participant is employed by a subsidiary of the Company, and such subsidiary is no longer at least 50% owned by the Company, then such Participant will be considered to have a Termination of Employment or Retirement on such date. Distribution of the Participant's benefits under Section 6 shall occur as provided therein. Notwithstanding the preceding sentences of this Paragraph, in the event that a Participant is employed by a subsidiary of the Company which is distributed to shareholders through a stock spin off to shareholders of ALLETE, then the Participant will not be considered to have a Termination of Employment or Retirement for purposes of Section 6 until their employment at such distributed company terminates for any reason, including Retirement.

4. Effective March 18, 2002, Section 6.4.1 is amended to add the following:

In the event that there is a Change in Control, and if, within twelve (12) months after a Change in Control a Participant is involuntarily terminated, the Participant shall be entitled to an additional benefit equal to forty percent (40%) of any amount distributed ("Supplemental Tax Benefit") pursuant to Section 6.4.1. If a Participant is eligible for Retirement, no Supplemental Tax Benefit will be paid.

ALLETE, Inc.

By: /s/ Donald J. Shippar
Donald J. Shippar
President and Chief Executive Officer

Attest: /s/ Philip R. Halverson
Philip R. Halverson
Vice President,
General Counsel & Secretary

AMENDMENT TO THE MINNESOTA POWER DIRECTOR STOCK PLAN

The Minnesota Power Director Stock Plan, effective May 9, 1995, is amended as follows:

1. Effective September 1, 2000, the title of the Plan is amended to be the ALLETE Director Stock Plan.

2. Effective January 1, 2002, Section V.B. is amended to provide as follows:

B. Each Director shall receive on the first business day following the Effective Date, and on each January 31 thereafter (or on the first business day thereafter if January 31 is not a business day) a Stock Payment of 1300 shares of Common Stock as a portion of the Annual Retainer payable to such Director for the Plan Year in which such date occurs. The cash portion of the Annual Retainer for such Plan Year shall be paid to Directors at such times and in such manner as may be determined by the Board of Directors. Directors joining the Board during the Plan Year after January 31 will receive their Stock Payment of 1300 shares of Common Stock on the first business day following the effective date of their election or appointment to the Board.

3. Effective January 1, 2003, Section V.B. is amended to provide as follows:

B. Each Director shall receive on the first business day in June following each annual meeting of shareholders, a Stock Payment equal in value to $47,500. To provide such Stock Payment to each Director, the Company shall cause shares of Common Stock to be purchased in the market and deposited to said Director's Dividend Reinvestment Plan Account on such date as a portion of the Annual Retainer payable to such Director for the

Plan Year in which such date occurs. Any fraction of a Share shall be disregarded and the remaining amount shall be paid in cash. The cash portion of the Annual Retainer for such Plan Year shall be paid to Directors at such times and in such manner as may be determined by the Board of Directors. Directors joining the Board during the Plan Year after the first business day in June will receive their Stock Payment on the first business day following the effective date of their election or appointment to the Board.

ALLETE, Inc.

By: /s/ Donald J. Shippar
Donald J. Shippar
President and Chief Executive Officer

Attest: /s/ Philip R. Halverson
Philip R. Halverson
Vice President,
General Counsel & Secretary

AMENDMENT TO THE ALLETE DIRECTOR COMPENSATION DEFERRAL PLAN

The ALLETE Director Compensation Deferral Plan (the "Plan") dated January 1, 1990, is amended as follows:

A new section 5.4 "Unscheduled Benefit Payments" is added as follows:

A Director may elect at any time prior to the time that the first payment from his or her account would otherwise be paid, to withdraw in a single lump sum all, or a specified portion of the balance of his or her Deferral Account. A Director may also make an election at any time subsequent to the start of installment payments from his or her account, to withdraw in a lump sum the entire balance of his or her Deferral Account. Withdrawals under this section will be reduced in amount by an early withdrawal penalty equal to ten percent of the amount requested, which will be deducted from the amount paid to the Director, and forfeited by the Director to the Company. Written notice of election to withdraw under this Section stating the lump sum amount withdrawn shall be sent to the General Counsel of the Company, and payment of the early withdrawal shall be made by the Company within thirty days of receipt of written notice.

ALLETE, Inc.,

By: /s/ Philip R. Halverson
Philip R. Halverson
Vice President, General Counsel
and Secretary

Exhibit 12

ALLETE
Computation of Ratios of Earnings to Fixed Charges (Unaudited)

For the Year Ended December 31	2003	2002	2001	2000	1999
Millions Except Ratios					
Income from Continuing Operations Before Income Taxes	$235.0	$191.1	$202.2	$213.0	$105.8
Add (Deduct)					
Undistributed Income from Less than 50% Owned Equity Investments	–	–	–	–	(0.6)
Minority Interest	–	–	0.1	–	1.8
	235.0	191.1	202.3	213.0	107.0
Fixed Charges					
Interest on Long-Term Debt	70.0	73.9	80.0	60.5	54.4
Capitalized Interest	1.2	0.8	1.0	0.9	0.7
Other Interest Charges — Net	4.3	5.3	12.9	15.9	12.0
Interest Component of All Rentals	8.0	9.9	10.4	8.5	4.8
Total Fixed Charges	83.5	89.9	104.3	85.8	71.9
Earnings Before Income Taxes and Fixed Charges (Excluding Capitalized Interest)	$317.3	$280.2	$305.6	$297.9	$178.2
Ratio of Earnings to Fixed Charges	3.80	3.12	2.93	3.47	2.48

Exhibit 23(a)

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-02109, 333-41882, 333-57104) and Form S-8 (Nos. 333-16445, 333-16463, 333-82901, 333-91348, 333-105225, 333-110740) of ALLETE, Inc. and its subsidiaries of our report dated February 9, 2004, except as to Note 3 which is as of March 8, 2004 relating to the consolidated financial statements and financial statement schedule, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP
Minneapolis, Minnesota
March 10, 2004

Exhibit 23(b)

CONSENT OF GENERAL COUNSEL

The statements of law and legal conclusions under “Item 1. Business” in ALLETE’s Annual Report on Form 10-K for the year ended December 31, 2003 have been reviewed by me and are set forth therein in reliance upon my opinion as an expert.

I hereby consent to the incorporation by reference of such statements of law and legal conclusions in Registration Statement Nos. 333-02109, 333-41882 and 333-57104 on Form S-3, and Registration Statement Nos. 333-16445, 333-16463, 333-82901, 333-91348, 333-105225 and 333-110740 on Form S-8.

/s/ Deborah A. Amberg

Deborah A. Amberg
Duluth, Minnesota
March 10, 2004

Exhibit 31(a)

RULE 13a-14(a)/15d-14(a) CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Donald J. Shippar, President and Chief Executive Officer of ALLETE, Inc. (ALLETE), certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2003 of ALLETE;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2004

/s/ Donald J. Shippar

Donald J. Shippar
President and Chief Executive Officer

Exhibit 31(b)

RULE 13a-14(a)/15d-14(a) CERTIFICATION BY THE CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James K. Vizanko, Senior Vice President, Chief Financial Officer and Treasurer of ALLETE, Inc. (ALLETE), certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2003 of ALLETE;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2004

/s/ James K. Vizanko

James K. Vizanko
Senior Vice President, Chief Financial Officer
and Treasurer

Exhibit 32

**SECTION 1350 CERTIFICATION OF ANNUAL REPORT
BY THE CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, each of the undersigned officers of ALLETE, Inc. (ALLETE), does hereby certify that:

1. The Annual Report on Form 10-K of ALLETE for the year ended December 31, 2003 (Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of ALLETE.

Date: March 10, 2004

/s/ Donald J. Shippar

Donald J. Shippar
President and Chief Executive Officer

Date: March 10, 2004

/s/ James K. Vizanko

James K. Vizanko
Senior Vice President, Chief Financial Officer
and Treasurer

This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability pursuant to that section. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that ALLETE specifically incorporates it by reference.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to ALLETE and will be retained by ALLETE and furnished to the Securities and Exchange Commission or its staff upon request.