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ALLETE INC
Form 11-K
June 04, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 11-K

(Mark One)

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

For the fiscal year ended DECEMBER 31, 2003

or

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

For the transition period from _____ to _____

Commission File No. 1-3548

MINNESOTA POWER AND AFFILIATED COMPANIES
RETIREMENT SAVINGS AND STOCK OWNERSHIP PLAN

(Full Title of the Plan)

ALLETE, Inc.
30 West Superior Street
Duluth, Minnesota 55802-2093

(Name of issuer of securities
held pursuant to the Plan and
the address of its principal
executive office)

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Note: Other schedules required by 29 CFR 2520.103.10 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 have been omitted because they are not applicable.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Participants and Administrator of the
Minnesota Power and Affiliated Companies
Retirement Savings and Stock Ownership Plan

In our opinion, the accompanying statement of net assets available for benefits and the related statement of changes in net assets available for benefits present fairly, in all material respects, the net assets available for benefits of the Minnesota Power and Affiliated Companies Retirement Savings and Stock Ownership Plan (the "Plan") at December 31, 2003 and 2002, and the changes in net assets available for benefits for the year 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 Plan'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 the standards of the Public Company Accounting Oversight Board (United States) and auditing standards generally accepted in the United States of America. Those standards 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.

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	357,603	280,813

LIABILITIES		
Accrued Interest	2,386	2,389
Long-Term Debt	71,182	73,441
	73,568	75,830

NET ASSETS AVAILABLE FOR BENEFITS	\$284,035	\$204,983

The accompanying notes are an integral part of these statements.

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MINNESOTA POWER AND AFFILIATED COMPANIES
RETIREMENT SAVINGS AND STOCK OWNERSHIP PLAN
STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
Thousands

	YEAR ENDED DECEMBER 31,	
	PARTICIPANT FUNDS	UNALLOCATED FUNDS

INVESTMENT INCOME		
Dividend Income	\$ 5,957	\$ 4,096
Interest Income	151	-
Net Appreciation in Fair Value of Investments	51,810	28,262
Other	282	-
	58,200	32,358

CONTRIBUTIONS		
Participant	7,239	-
Employer	-	2,094
Rollover	183	-
	7,422	2,094

DEDUCTIONS		
Participants' Withdrawals	(11,723)	-
Interest Expense	-	(7,262)
Administrative Expenses	-	(80)
	(11,723)	(7,342)

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TRANSFERS AND ALLOCATIONS		
Transfers to Retirement Plans	(1,957)	-
Allocations to Participants	3,394	(3,394)
	1,437	(3,394)

NET INCREASE	55,336	23,716
NET ASSETS AVAILABLE FOR BENEFITS		
Beginning of Year	194,053	10,930
End of Year	\$249,389	\$34,646

The accompanying notes are an integral part of these statements.

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MINNESOTA POWER AND AFFILIATED COMPANIES RETIREMENT SAVINGS AND STOCK OWNERSHIP PLAN NOTES TO FINANCIAL STATEMENTS

NOTE 1 - DESCRIPTION OF THE PLAN

The Minnesota Power and Affiliated Companies Retirement Savings and Stock Ownership Plan (RSOP or Plan) is a contributory defined contribution plan subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and qualifies as an employee stock ownership plan and profit sharing plan. At December 31, 2003 there were 1,904 participants in the RSOP. Participating affiliated companies (collectively, the Companies) at December 31, 2003 included:

- ALLETE, Inc. (ALLETE, or Company)
- Minnesota Power (an operating division of ALLETE)
- Superior Water, Light and Power Company
- Enventis Telecom, Inc.
- MP Affiliate Resources, Inc.

The RSOP provides eligible employees of the Companies an opportunity to save for retirement by electing to make before-tax and after-tax contributions through payroll deduction, and directing the contributions into various 401(k) investment options. (See Participant Investment Options.) The RSOP also provides eligible employees of the Companies employee stock ownership benefits in ALLETE common stock (Common Stock).

BASIS OF PRESENTATION

Participant funds represent the participants' 401(k) investment funds and shares allocated to participants in the ALLETE RSOP Stock Fund. Unallocated funds represent unallocated shares in the ALLETE RSOP Stock Fund.

ADMINISTRATION

The Plan is administered for the Companies by the Employee Benefit Plans

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Committee (Committee). The mailing address of the Committee is 30 West Superior Street, Duluth, Minnesota 55802-2093. The Committee consists of 10 members who were appointed by the Board of Directors of ALLETE. The Board of Directors has the power to remove members of the Committee from office. Members of the Committee receive no compensation for their services with respect to the Plan.

The responsibility of the Committee includes the determination of compliance with the Plan's eligibility requirements as well as the administration and payment of benefits in a manner consistent with the terms of the Plan and applicable law. The Committee has the authority to establish, modify and repeal policies and procedures as it may deem necessary to carry out the provisions of the Plan. The Committee also has the authority to designate persons to carry out fiduciary responsibilities (other than trustee responsibilities) under the Plan. The Committee has the power to appoint an investment manager or managers (as defined by ERISA), attorneys, accountants and such other persons as it shall deem necessary or desirable in the administration of the Plan. Administration fees and expenses of agents, outside experts, consultants and investment managers are paid by the Companies or the Plan. The Plan charges participants who take plan loans or use the Plan's self-directed account feature for expenses relating to such loans or accounts.

American Express Retirement Services, a service group of American Express Financial Advisors Inc., and American Express Trust Company (collectively, American Express) is the service provider for the Plan handling participant recordkeeping and certain other administrative responsibilities. American Express allows the Plan to value accounts daily and gives participants greater flexibility with regard to investment of their account balances. American Express Trust Company (Trustee), which is located at 994 AXP Financial Center, Minneapolis, Minnesota, 55474-0507, is the trustee for the Plan. The Trustee carries \$25 million of blanket bond insurance and \$5 million of professional liability insurance.

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PARTICIPANT INVESTMENT OPTIONS

The Plan's 401(k) investment fund options at December 31, 2003 are listed below. Detailed descriptions of the investment options and risk profiles are available in the corresponding fund's prospectus.

- ALLETE Stock Fund
- AllianceBernstein Growth and Income Fund
- American Express Trust Bond Index Fund II
- American Express Trust Emerging Growth Fund II
- American Express Trust Income Fund II
- American Express Trust Small Cap Equity Index Fund II
- The Artisan International Fund
- AXP New Dimensions Fund
- Fidelity Magellan Fund
- Janus Balanced Fund
- Oppenheimer Developing Markets Fund
- Royce Low-Priced Stock Fund
- Templeton Foreign Fund
- Vanguard Institutional Index Fund
- Vanguard Mid-Cap Index Fund

Participants may also establish a self-directed brokerage account which allows the participant to make investments in or transfers to a wide range of securities, including publicly traded stock, bonds and mutual funds. Participants that have a self-directed brokerage account pay an annual fee in

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addition to any trading fees incurred upon investment changes. Participants may change their level of contribution, change their investment election for future contributions and make transfers between investment options at any time by contacting American Express.

EMPLOYEE STOCK OWNERSHIP BENEFITS - ALLETE RSOP STOCK FUND

Eligible employees of the Companies receive Common Stock ownership benefits in the ALLETE RSOP Stock Fund. These benefits are primarily funded by payments made by the Plan on two loans (see First Suspense Account and Second Suspense Account). Shares of Common Stock are allocated to eligible employees as provided by the Plan (see Basic Account, Special Account, Partnership Account, Bargaining Unit Account and Matching Account). The shares of Common Stock allocated to a participant's ALLETE RSOP Stock Fund come from the First and Second Loan Suspense Accounts, as determined by ALLETE. Each participant's account value, however, is determined on a unit basis and consists of both Common Stock and cash. (See Note 4.) The unit value is adjusted each business day to reflect investment results including cash.

With the exception of a participant's Pre-1989 Basic Account, dividends are automatically reinvested in Common Stock held in the ALLETE RSOP Stock Fund. Participants with a Pre-1989 Basic Account may make an election at any time to receive dividends paid on their Pre-1989 Basic Account in cash. Units within a participant's Pre-1989 Basic Account can be withdrawn at any time, while all other units within a participant's ALLETE RSOP Stock Fund can be withdrawn when the participant reaches age 59 1/2 or terminates employment. Participants may transfer all or any part of their ALLETE RSOP Stock Fund excluding their Pre-1989 Basic Account to other 401(k) investments options at any time.

FIRST SUSPENSE ACCOUNT. In 1989 the RSOP was amended to establish a leveraged First Suspense Account. The First Suspense Account originally consisted of 633,849 shares of Common Stock purchased for the benefit of eligible Plan participants with proceeds from a 15-year \$16.5 million loan (First Loan) bearing interest at 9.125%. This loan was obtained on December 29, 1989, and is guaranteed by ALLETE. Effective June 28, 2002 this loan was refinanced by LaSalle Bank National Association with a variable interest rate equal to LIBOR plus 1.75% fixed for 30, 60, 90 or 180 days at ALLETE's option. At December 31, 2003 the interest rate was 2.92%. The First Suspense Account provides that as the First Loan is repaid, shares of Common Stock in the First Suspense Account are allocated to each participant's various ALLETE RSOP Stock Fund accounts based on the applicable allocation methods as defined in the Plan and summarized below.

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SECOND SUSPENSE ACCOUNT. The RSOP was again amended in 1990 to establish a leveraged Second Suspense Account and borrow an additional \$75 million (Second Loan) to acquire 2,830,188 newly issued shares of Common Stock from ALLETE for the benefit of active Plan participants with a Basic Account. Under this amendment, active participants with a Basic Account are allocated shares to their Special Account with a value at least equal to: (a) dividends payable on shares held by those participants in the Plan and (b) tax savings generated from the deductibility of dividends paid on all shares of Common Stock held in the RSOP as of August 4, 1989. In accordance with this amendment, the trustee issued a promissory note to ALLETE for \$75 million at a 10.25% interest rate with a term not to exceed 25 years.

BASIC ACCOUNT. Participants' Basic Accounts received shares of Common Stock purchased with incremental investment tax credit contributions and payroll-based tax credit contributions. Contributions to the participants' Basic Accounts ceased after 1986.

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SPECIAL ACCOUNT. For the years 1985 through 1989, the Companies received a tax deduction for cash dividends paid to participants on ALLETE RSOP Stock Fund shares in their Basic Account. The Companies contributed to the ALLETE RSOP Stock Fund an amount equal to the estimated income tax benefit of the dividend deduction associated with shares in the Basic Account. Shares of Common Stock purchased with these contributions were allocated to the participants' Special Account.

PARTNERSHIP ACCOUNT. Since 1989 partnership allocations have been made to each nonunion participant's Partnership Account based on the ratio of a participant's annual compensation to the annual compensation of all eligible participants. If the value of the shares credited to a participant's Partnership Account is less than 3.5 percent of the participant's eligible annual compensation, the Companies will contribute additional shares to make up the difference.

BARGAINING UNIT ACCOUNT. Quarterly non-elective allocations are made to the ALLETE RSOP Stock Fund equal to 0.75 percent of each union participant's eligible compensation.

MATCHING ACCOUNT. Quarterly matching allocations are made to the ALLETE RSOP Stock Fund equal to 50 percent of each nonunion participant's 401(k) before-tax contributions, disregarding contributions in excess of 4 percent of the participant's periodic pay for the period (8 percent for Enventis Telecom, Inc. employees).

CONTRIBUTIONS

PARTICIPANT CONTRIBUTIONS to the Plan consist of the following:

- BEFORE-TAX CONTRIBUTIONS. Before-tax contributions consist of salary reduction contributions, results sharing contributions and flexible dollar contributions. Total before-tax contributions in 2003 could not exceed \$12,000 for participants less than age 50 or \$14,000 for participants at least age 50, as permitted under Section 401(k) of the Internal Revenue Code of 1986.
- SALARY REDUCTION CONTRIBUTIONS. Salary reduction contributions are equal to an amount the participant has elected to reduce his or her compensation pursuant to a salary reduction agreement.
- RESULTS SHARING CONTRIBUTIONS. Results sharing contributions are equal to the portion (up to 100 percent) of the Results Sharing Award the participant irrevocably agrees to forgo and that, pursuant to the ALLETE Results Sharing Program, would otherwise be paid to the participant.
- FLEXIBLE DOLLAR CONTRIBUTIONS. Nonunion participants may make flexible dollar contributions equal to the portion (up to 100 percent) of flexible dollars the participant irrevocably agrees to forgo and that, pursuant to the Minnesota Power and Affiliated Companies Flexible Compensation Plan, would otherwise be used for other benefits or paid to the participant.

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- VOLUNTARY CONTRIBUTIONS (AFTER-TAX CONTRIBUTIONS). Each participant is also allowed to make voluntary after-tax contributions to the Plan through payroll deductions. Total voluntary contributions made by a participant shall not exceed 25 percent of the participant's

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compensation per pay period.

- ROLLOVERS. Contributions by participants may also be made through rollovers from other qualified plans.

EMPLOYER CONTRIBUTIONS for each year are paid to the Trustee either in cash or in Common Stock. Expenses incurred in discretionary activities relating to the design, formation and modification of the Plan (commonly characterized as "settlor" functions) are paid by the Companies.

VESTING AND FORFEITURE ACCOUNT

As of July 1, 2001 all contributions plus actual earnings thereon are fully vested and nonforfeitable. A forfeiture account, which consists of previously forfeited nonvested accounts, totaled \$33,000 at December 31, 2003 (\$114,000 at December 31, 2002) and is invested in American Express Trust Income Fund II. Dollars from the forfeiture account will be used to reduce future Plan expenses.

DISTRIBUTIONS AND WITHDRAWALS

A participant may elect at any time to receive in cash future dividends paid on Common Stock shares in their ALLETE RSOP Stock Fund Pre-1989 Basic Account and ALLETE Stock Fund.

Prior to termination a participant may withdraw at any time all or any part of their:

- Plan accounts, if the participant has attained age 59 1/2;
- After-tax account, regardless of the participant's age; or
- Pre-1989 Basic Account, regardless of the participant's age.

When participants terminate employment, become disabled or die, they or their beneficiaries may elect to receive all or any part of their Plan accounts.

TRANSFERS TO RETIREMENT PLANS. Upon retirement, participants may elect to transfer their Plan account balances to the Minnesota Power and Affiliated Companies Retirement Plan A or Plan B, if the participant is receiving a benefit from one of these retirement plans. The amount of transfers to these retirement plans totaled \$1,957,000 for 2003.

LOAN PROGRAM. The Plan allows participants to borrow money from their Plan accounts. The maximum amount a participant may borrow is equal to the lesser of (a) the participant's aggregate before-tax account, after-tax account and rollover account balances, (b) 50 percent of their total Plan balance, or (c) \$50,000. The loans may not be less than \$1,000. The loans are for terms up to five years for a general purpose loan and ten years for the acquisition of a primary residence. A fixed interest rate of the prime rate plus 1 percent on the first day of the month that the loan is originated is charged until the loan is repaid. As loans are repaid, generally through payroll deductions, principal and interest amounts are redeposited into the participant's Plan accounts. Participants are required to pay a \$50 loan application fee to cover the cost of processing the loan.

PLAN TERMINATION

The Companies reserve the right to reduce, suspend or discontinue their contributions to the Plan at any time or to terminate the Plan in its entirety subject to the provisions of ERISA and the Internal Revenue Code of 1986 (Code). If the Plan is terminated, all of the account balances of the participants will be distributed in accordance with the terms of the Plan.

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NOTE 2 - SUMMARY OF ACCOUNTING POLICIES

The Plan uses the accrual basis of accounting and, accordingly, reflects income in the year earned and expenses when incurred. Common stock and mutual fund investments are reported at their fair value based on quoted market prices. Collective fund investments are reported at net asset value which approximates fair value. Participants' loans are reported at estimated fair value which represents outstanding principal and any related accrued interest.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and changes therein, and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

The Plan presents, in the statement of changes in net assets available for benefits, the net appreciation (depreciation) in the fair value of its investments which consists of the realized gains or losses and the unrealized appreciation (depreciation) on those investments.

The Plan invests in various funds that are a combination of stocks, bonds and other investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits.

The financial information for prior periods has been reclassified to present comparable information for all periods.

NOTE 3 - FEDERAL INCOME TAX STATUS

A favorable determination letter dated March 23, 2004 was obtained from the Internal Revenue Service stating that the RSOP, as amended and restated effective January 1, 2002, qualified as an employee stock ownership plan and a profit sharing plan under Section 401(a) of the Code.

The Plan has subsequently been amended and the Committee continues to believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

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NOTE 4 - INVESTMENTS

FAIR/NET ASSET VALUE OF INVESTMENTS
REPRESENTING 5 PERCENT OR MORE OF ASSETS

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AS OF DECEMBER 31,	2003

Thousands	
ALLETE RSOP Stock Fund	\$217,334
ALLETE Stock Fund	27,453
American Express Trust Income Fund II	32,575
Other Investments	79,103

	\$356,465

ALLETE RSOP STOCK FUND			NUMBER OF	COST	
			SHARES		

Thousands					
December 31, 2003	Allocated	-	Common Stock	3,587	\$40,296
			Cash		954

					41,250

	Unallocated	-	Common Stock	3,432	45,249
			Cash		1,607

					46,856

					\$88,106

December 31, 2002	Allocated	-	Common Stock	3,803	\$41,924
			Cash		483

					42,407

	Unallocated	-	Common Stock	3,702	48,711
			Cash		1,686

					50,397

					\$92,804

For the ALLETE Stock Fund and the ALLETE RSOP Stock Fund, each participant's account value is determined on a unit basis and consists of both Common Stock and cash. The unit value is adjusted each business day to reflect investment results including cash.

AS OF DECEMBER 31,	ALLETE STOCK FUND		ALLETE RS
	2003	2002	2003

Thousands			
Number of Units	2,408	2,457	9,140
Common Stock	\$26,977	\$20,443	\$109,772
Cash	476	446	954

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Net Value	\$27,453	\$20,889	\$110,726
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NOTE 5 - REPAYMENT OF LOANS

The Trustee repays principal and interest on the First Loan and Second Loan with dividends paid on the shares of Common Stock in each suspense account and with certain employer contributions to the Plan. The shares of Common Stock acquired by the Trustee are held in the First Suspense Account and Second Suspense Account, and allocated to the accounts of Plan participants as the First Loan and Second Loan are repaid.

The First Loan was obtained from a third party lender and is guaranteed by ALLETE with 61,704 unallocated shares of Common Stock in the Plan pledged as collateral at December 31, 2003. The lender has no rights against shares that are allocated under the Plan. In December 2003 the Plan made a principal payment of \$2,259,000 on the First Loan. The First Loan has one remaining principal payment of \$1,364,000 due in December 2004.

The Second Loan was obtained from ALLETE. There were 3,369,688 unallocated shares of Common Stock in the Plan pledged as collateral at December 31, 2003. Prepayments can be made without penalty. The lender has no rights against shares that are allocated under the Plan.

PRINCIPAL PAYMENTS \$75 MILLION 10.25% LOAN

Thousands	
2011	\$ 9,818
2012	15,000
2013	15,000
2014	15,000
2015	15,000

	\$69,818

NOTE 6 - SUBSEQUENT EVENT

In October 2003 ALLETE's Board of Directors approved a plan to spin off to ALLETE shareholders its Automotive Services business which will become a publicly traded company doing business as ADESA, Inc. (ADESA). The spin-off is expected to take the form of a tax-free stock dividend to ALLETE's shareholders, who would receive a pro rata number of shares of ADESA common stock for each share of ALLETE Common 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.

Participants in the ALLETE RSOP Stock Fund and the ALLETE Stock Fund are expected to receive a pro rata share of ADESA common stock based on the unitization formula used to determine a participant's equivalent number of ALLETE shares on the date of the spin-off. The Company is in the process of

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developing plans for participants to make decisions about these shares of ADESA.

Subsequent to the spin-off of ADESA, the RSOP will have a significant amount of cash generated from the sale of ADESA stock received in the spin-off on a pro rata basis for the unallocated shares. 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 Common Stock, the Company has requested IRS approval to extend the purchase period to approximately 600 days. The IRS ruling on this request is expected later in 2004.

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MINNESOTA POWER AND AFFILIATED COMPANIES
RETIREMENT SAVINGS AND STOCK OWNERSHIP PLAN
SCHEDULE OF ASSETS (HELD AT END OF YEAR)
AS OF DECEMBER 31, 2003
Thousands

(a)

(b)

(c)

(d)

IDENTITY OF ISSUER

DESCRIPTION OF
INVESTMENT

CO