

ITC Holdings Corp.  
Form 10-Q  
October 31, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the Quarterly Period Ended September 30, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

Commission File Number: 001-32576

ITC HOLDINGS CORP.

(Exact Name of Registrant as Specified in Its Charter)

Michigan

(State or Other Jurisdiction of Incorporation or  
Organization)

32-0058047

(I.R.S. Employer Identification No.)

27175 Energy Way

Novi, MI 48377

(Address Of Principal Executive Offices, Including Zip Code)

(248) 946-3000

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting  
company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares of the Registrant's Common Stock, without par value, outstanding as of October 25, 2013 was 52,478,610.

Table of Contents

ITC Holdings Corp.  
Form 10-Q for the Quarterly Period Ended September 30, 2013  
INDEX

	Page
<u>Part I. Financial Information</u>	<u>4</u>
<u>Item 1. Financial Statements</u>	<u>4</u>
<u>Condensed Consolidated Statements of Financial Position (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Operations (Unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Unaudited)</u>	<u>6</u>
<u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u>	<u>7</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>8</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>22</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>35</u>
<u>Item 4. Controls and Procedures</u>	<u>36</u>
<u>Part II. Other Information</u>	<u>36</u>
<u>Item 1A. Risk Factors</u>	<u>36</u>
<u>Item 2. Unregistered Sale of Equity Securities and Use of Proceeds</u>	<u>37</u>
<u>Item 6. Exhibits</u>	<u>38</u>
<u>Signatures</u>	<u>39</u>
Exhibit Index	

Table of Contents

DEFINITIONS

Unless otherwise noted or the context requires, all references in this report to:

ITC Holdings Corp. and its subsidiaries

“ITC Great Plains” are references to ITC Great Plains, LLC, a wholly-owned subsidiary of ITC Grid Development, LLC;

“ITC Grid Development” are references to ITC Grid Development, LLC, a wholly-owned subsidiary of ITC Holdings;

“Green Power Express” are references to Green Power Express LP, an indirect wholly-owned subsidiary of ITC Holdings;

“ITC Holdings” are references to ITC Holdings Corp. and not any of its subsidiaries;

“ITC Midwest” are references to ITC Midwest LLC, a wholly-owned subsidiary of ITC Holdings;

“ITC Transmission” are references to International Transmission Company, a wholly-owned subsidiary of ITC Holdings;

“METC” are references to Michigan Electric Transmission Company, LLC, a wholly-owned subsidiary of MTH;

“MISO Regulated Operating Subsidiaries” are references to ITC Transmission, METC and ITC Midwest together;

“MTH” are references to Michigan Transco Holdings, LLC, the sole member of METC and an indirect wholly-owned subsidiary of ITC Holdings;

“Regulated Operating Subsidiaries” are references to ITC Transmission, METC, ITC Midwest and ITC Great Plains together; and

“We,” “our” and “us” are references to ITC Holdings together with all of its subsidiaries.

Other definitions

“Consumers Energy” are references to Consumers Energy Company, a wholly-owned subsidiary of CMS Energy Corporation;

“Detroit Edison” are references to The Detroit Electric Company, a wholly-owned subsidiary of DTE Energy Company;

“Entergy” are references to Entergy Corporation;

“Entergy Transaction” are references to the transaction whereby the electric transmission business of Entergy will be separated and subsequently merged with a wholly-owned subsidiary of ITC Holdings;

“FERC” are references to the Federal Energy Regulatory Commission;

“FPA” are references to the Federal Power Act;

“IP&L” are references to Interstate Power and Light Company, an Alliant Energy Corporation subsidiary;

“ITC Holdings’ annual report on Form 10-K” are references to the annual report on Form 10-K filed on March 1, 2013;

“kV” are references to kilovolts (one kilovolt equaling 1,000 volts);

“kW” are references to kilowatts (one kilowatt equaling 1,000 watts);

“LIBOR” are references to the London Interbank Offered Rate;

“MISO” are references to the Midcontinent Independent System Operator, Inc. (formerly known as the Midwest Independent Transmission System Operator, Inc.), a FERC-approved RTO which oversees the operation of the bulk power transmission system for a substantial portion of the Midwestern United States and Manitoba, Canada, and of which ITC Transmission, METC and ITC Midwest are members;

“MW” are references to megawatts (one megawatt equaling 1,000,000 watts);

“NERC” are references to the North American Electric Reliability Corporation;

“RTO” are references to Regional Transmission Organizations; and

“SPP” are references to Southwest Power Pool, Inc., a FERC-approved RTO which oversees the operation of the bulk power transmission system for a substantial portion of the South Central United States, and of which ITC Great Plains is a member.

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## ITC HOLDINGS CORP. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

(in thousands, except share data)	September 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$50,704	\$26,187
Accounts receivable	103,585	72,192
Inventory	36,282	37,357
Deferred income taxes	18,925	23,014
Regulatory assets — revenue accruals, including accrued interest	6,620	7,489
Prepaid and other current assets	18,053	31,987
Total current assets	234,169	198,226
Property, plant and equipment (net of accumulated depreciation and amortization of \$1,319,710 and \$1,269,810, respectively)	4,687,581	4,134,579
Other assets		
Goodwill	950,163	950,163
Intangible assets (net of accumulated amortization of \$20,801 and \$18,397, respectively)	49,431	48,492
Other regulatory assets	186,926	180,378
Deferred financing fees (net of accumulated amortization of \$14,390 and \$17,838, respectively)	26,279	19,293
Other	37,851	33,678
Total other assets	1,250,650	1,232,004
<b>TOTAL ASSETS</b>	<b>\$6,172,400</b>	<b>\$5,564,809</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$105,285	\$123,022
Accrued payroll	17,738	20,740
Accrued interest	30,170	44,708
Accrued taxes	17,650	28,117
Regulatory liabilities — revenue deferrals, including accrued interest	38,296	53,763
Refundable deposits from generators for transmission network upgrades	29,656	40,745
Debt maturing within one year	210,000	651,929
Other	16,759	40,287
Total current liabilities	465,554	1,003,311
Accrued pension and postretirement liabilities	58,395	53,243
Deferred income taxes	555,038	460,072
Regulatory liabilities — revenue deferrals, including accrued interest	74,223	28,613
Regulatory liabilities — accrued asset removal costs	70,226	75,477
Refundable deposits from generators for transmission network upgrades	15,392	7,623
Other	20,139	26,317
Long-term debt	3,364,900	2,495,298
Commitments and contingent liabilities (Note 11)		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, without par value, 100,000,000 shares authorized, 52,471,354 and 52,248,514 shares issued and outstanding at September 30, 2013 and December 31,	1,003,709	989,334

Edgar Filing: ITC Holdings Corp. - Form 10-Q

2012, respectively		
Retained earnings	538,317	443,569
Accumulated other comprehensive income (loss)	6,507	(18,048 )
Total stockholders' equity	1,548,533	1,414,855
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$6,172,400</b>	<b>\$5,564,809</b>
See notes to condensed consolidated financial statements (unaudited).		

Table of Contents

## ITC HOLDINGS CORP. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
OPERATING REVENUES	\$238,782	\$214,801	\$685,903	\$608,889
OPERATING EXPENSES				
Operation and maintenance	29,725	31,544	83,906	90,314
General and administrative	31,902	27,906	110,767	78,791
Depreciation and amortization	29,802	27,466	87,583	78,453
Taxes other than income taxes	16,728	14,721	49,492	44,186
Other operating (income) and expenses — net	(197 )	(190 )	(542 )	(586 )
Total operating expenses	107,960	101,447	331,206	291,158
OPERATING INCOME	130,822	113,354	354,697	317,731
OTHER EXPENSES (INCOME)				
Interest expense — net	44,062	38,924	123,527	116,918
Allowance for equity funds used during construction	(8,290 )	(5,622 )	(25,315 )	(15,800 )
Other income	(786 )	(884 )	(824 )	(2,171 )
Other expense	2,164	1,415	5,388	2,473
Total other expenses (income)	37,150	33,833	102,776	101,420
INCOME BEFORE INCOME TAXES	93,672	79,521	251,921	216,311
INCOME TAX PROVISION	34,688	28,338	95,352	76,691
NET INCOME	\$58,984	\$51,183	\$156,569	\$139,620
Basic earnings per common share	\$1.12	\$0.99	\$2.99	\$2.72
Diluted earnings per common share	\$1.12	\$0.98	\$2.96	\$2.68
Dividends declared per common share	\$0.4250	\$0.3775	\$1.1800	\$1.0825
See notes to condensed consolidated financial statements (unaudited).				

Table of Contents

## ITC HOLDINGS CORP. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
NET INCOME	\$58,984	\$51,183	\$156,569	\$139,620
OTHER COMPREHENSIVE INCOME (LOSS)				
Derivative instruments, net of tax (Note 6)	110	(1,316)	) 24,468	(5,440 )
Available-for-sale securities, net of tax (Note 6)	87	—	87	—
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	197	(1,316)	) 24,555	(5,440 )
TOTAL COMPREHENSIVE INCOME	\$59,181	\$49,867	\$181,124	\$134,180

See notes to condensed consolidated financial statements (unaudited).

Table of Contents

## ITC HOLDINGS CORP. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)	Nine months ended September 30,	
	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$156,569	\$139,620
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	87,583	78,453
Recognition, refund and collection of revenue accruals and deferrals — including accrued interest	30,369	25,748
Deferred income tax expense	69,733	44,921
Allowance for equity funds used during construction	(25,315)	(15,800)
Other	13,113	9,030
Changes in assets and liabilities, exclusive of changes shown separately:		
Accounts receivable	(31,115)	(12,182)
Inventory	1,075	979
Prepaid and other current assets	11,208	(5,776)
Accounts payable	4,044	(10,637)
Accrued payroll	(1,707)	(1,865)
Accrued interest	(14,538)	(247)
Accrued taxes	(10,467)	(5,773)
Other current liabilities	7,979	11,474
Other non-current assets and liabilities, net	(6,328)	410
Net cash provided by operating activities	292,203	258,355
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Expenditures for property, plant and equipment	(630,485)	(637,386)
Proceeds from sale of securities	42,174	5,935
Purchases of securities	(43,398)	(10,786)
Other	(3,340)	(747)
Net cash used in investing activities	(635,049)	(642,984)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of long-term debt	933,025	100,000
Borrowings under revolving credit agreements	890,400	1,073,550
Borrowings under term loan credit agreements	535,000	200,000
Retirement of long-term debt	(452,000)	—
Repayments of revolving credit agreements	(1,004,100)	(960,350)
Repayments of term loan credit agreements	(475,000)	—
Issuance of common stock	8,213	4,929
Dividends on common and restricted stock	(61,821)	(55,677)
Refundable deposits from generators for transmission network upgrades	26,898	31,157
Repayment of refundable deposits from generators for transmission network upgrades	(30,279)	(31,186)
Other	(2,973)	(6,112)
Net cash provided by financing activities	367,363	356,311
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>24,517</b>	<b>(28,318)</b>
<b>CASH AND CASH EQUIVALENTS — Beginning of period</b>	<b>26,187</b>	<b>58,344</b>
<b>CASH AND CASH EQUIVALENTS — End of period</b>	<b>\$50,704</b>	<b>\$30,026</b>
See notes to condensed consolidated financial statements (unaudited).		





Table of Contents

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 1. GENERAL

These condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements as of and for the year ended December 31, 2012 included in ITC Holdings' annual report on Form 10-K for such period.

The accompanying condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America ("GAAP") and with the instructions to Form 10-Q and Rule 10-01 of Securities and Exchange Commission ("SEC") Regulation S-X as they apply to interim financial information.

Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These accounting principles require us to use estimates and assumptions that impact the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results may differ from our estimates.

The condensed consolidated financial statements are unaudited, but in our opinion include all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the results for the interim period. The interim financial results are not necessarily indicative of results that may be expected for any other interim period or the fiscal year.

## Supplementary Cash Flows Information

	Nine months ended September 30,	
(in thousands)	2013	2012
Supplementary cash flows information:		
Interest paid (net of interest capitalized)	\$135,058	\$112,040
Income taxes paid — net	11,593	26,024
Supplementary non-cash investing and financing activities:		
Additions to property, plant and equipment (a)	\$74,694	\$77,464
Allowance for equity funds used during construction	25,315	15,800

(a) Amounts consist of current liabilities for construction labor and materials that have not been included in investing activities. These amounts have not been paid for as of September 30, 2013 or 2012, respectively, but have been or will be included as a cash outflow from investing activities for expenditures for property, plant and equipment when paid.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

## Presentation of Comprehensive Income

The guidance set forth by the Financial Accounting Standards Board ("FASB") has been updated with respect to the presentation of comprehensive income in financial statements. Under this guidance, we are required to (1) disclose the changes in accumulated other comprehensive income ("AOCI") by component and (2) disclose the effects on the line items of net income of significant amounts reclassified out of AOCI. We adopted this guidance as of January 1, 2013. For the three and nine months ended September 30, 2013, the requirements under (1) above are presented in the condensed consolidated statements of comprehensive income and the requirements under (2) above are disclosed in Note 6 of this Form 10-Q.

## Balance Sheet Offsetting Requirements

The FASB has created new disclosure requirements regarding the nature of an entity's rights of offset and related arrangements associated with its financial instruments and derivative instruments. The guidance requires entities to disclose, at a minimum, the following information in tabular format, separately for assets and liabilities: (a) the gross amounts of those recognized assets and those recognized liabilities; (b) the amounts offset to determine the net amounts presented in the statement of financial position; (c) the net amounts presented in the statement of financial position; (d) the amounts subject to an enforceable master netting arrangement or similar agreement; and (e) the net amount after deducting the amounts in (d) from the amounts in (c). We adopted this guidance as of January 1, 2013. As of September 30, 2013, we did not have any material assets and liabilities that are subject to the new disclosure

requirements.

8

---

Table of Contents

## 3. REGULATORY MATTERS

## ITC Great Plains

As of September 30, 2013, we have recorded a total of \$13.9 million of regulatory assets for start-up, development and pre-construction expenses, including associated carrying charges, incurred by ITC Great Plains, which include certain costs incurred for the Kansas Electric Transmission Authority (“KETA”) Project and the Kansas V-Plan Project prior to construction. ITC Great Plains made a filing with the FERC under Section 205 of the FPA in May 2013 to recover these start-up, development and pre-construction expenses, including associated carrying charges, in future rates. If FERC authorization is received, ITC Great Plains will include the unamortized balance of the regulatory assets in its rate base and will amortize them over a 10-year period beginning at the later of the project in-service date or the FERC authorization date. The amortization expense will be recovered through ITC Great Plains’ cost-based formula rate template beginning in the period in which amortization begins.

## Order on Formula Rate Protocols

On May 17, 2012, the FERC issued an order pursuant to Section 206 of the FPA to determine whether the formula rate protocols under the MISO Tariff are sufficient to ensure just and reasonable rates. Our MISO Regulated Operating Subsidiaries were named in the order. On May 16, 2013, the FERC issued an order that determined the formula rate protocols are insufficient to ensure just and reasonable rates and directed MISO and its member transmission owners to file revised formula rate protocols. On September 13, 2013, MISO and its member transmission owners, including our MISO Regulated Operating Subsidiaries, filed revised formula rate protocols which will require our MISO Regulated Operating Subsidiaries to provide additional information for certain aspects of the formula rates used to calculate their respective annual revenue requirements. We do not expect the revised formula rate protocols to impact our results of operations, cash flows or financial condition.

## Complaint of IP&amp;L

On September 14, 2012, IP&L filed a complaint with the FERC against ITC Midwest’s reimbursement policy under Section 206 of the FPA. The complaint challenged ITC Midwest’s FERC-approved reimbursement policy for network upgrades to qualifying generators. On July 18, 2013, FERC issued an order indicating that the use of Attachment FF was no longer just and reasonable and required MISO, on behalf of ITC Midwest, to prospectively revise ITC Midwest’s Attachment FF of the MISO Tariff to conform to the generator interconnection cost recovery provisions used in other MISO pricing zones. The order would not modify agreements executed or filed unexecuted prior to July 18, 2013. On August 14, 2013, MISO made the required compliance filing to revise ITC Midwest’s Attachment FF of the MISO Tariff. On August 16, 2013, ITC Midwest filed for rehearing of this matter with FERC. We do not expect the revised policy to have a material impact on our results of operations, cash flows or financial condition.

## Cost-Based Formula Rates with True-Up Mechanism

The transmission rates at our Regulated Operating Subsidiaries are set annually, using the FERC-approved formula rates, and the rates remain in effect for a one-year period. By completing their formula rate templates on an annual basis, our Regulated Operating Subsidiaries are able to adjust their transmission rates to reflect changing operational data and financial performance, including the amount of network load on their transmission systems (for our MISO Regulated Operating Subsidiaries), operating expenses and additions to property, plant and equipment when placed in service, among other items. The FERC-approved formula rates do not require further action or FERC filings for the calculated joint zone rates to go into effect, although the rates are subject to legal challenge at the FERC. Our Regulated Operating Subsidiaries will continue to use formula rates to calculate their respective annual revenue requirements unless the FERC determines the rates to be unjust and unreasonable or another mechanism is determined by the FERC to be just and reasonable.

Our cost-based formula rate templates include a true-up mechanism, whereby our Regulated Operating Subsidiaries compare their actual revenue requirements to their billed revenues for each year to determine any over- or under-collection of revenue requirements. The over- or under-collection typically results from differences between the projected revenue requirement used to establish the billing rate and actual revenue requirement at each of our Regulated Operating Subsidiaries, or from differences between actual and projected monthly peak loads at our MISO Regulated Operating Subsidiaries. Revenue is recognized for services provided during each reporting period based on actual revenue requirements calculated using the formula rate templates. Our Regulated Operating Subsidiaries accrue

or defer revenues to the extent that the actual revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. The amount of accrued or deferred revenues is reflected in customer bills within two years under the provisions of the formula rate templates.

Table of Contents

The current and non-current regulatory assets are recorded on the balance sheet in regulatory assets — revenue accruals, including accrued interest and other non-current assets, respectively. The current and non-current regulatory liabilities are recorded in regulatory liabilities — revenue deferrals, including accrued interest. The net changes in regulatory assets and liabilities associated with our Regulated Operating Subsidiaries' formula rate revenue accruals and deferrals, including accrued interest, were as follows during the nine months ended September 30, 2013:

(in thousands)	Total
Balance as of December 31, 2012	\$(72,168 )
Net refund of 2011 revenue deferrals and accruals, including accrued interest	35,296
Net revenue deferral for the nine months ended September 30, 2013	(63,628 )
Net accrued interest payable for the nine months ended September 30, 2013	(2,037 )
Balance as of September 30, 2013	\$(102,537 )

Regulatory assets and liabilities associated with our Regulated Operating Subsidiaries' formula rate revenue accruals and deferrals are recorded in our condensed consolidated statements of financial position as follows:

(in thousands)	Total
Current assets	\$6,620
Non-current assets — other	3,362
Current liabilities	(38,296 )
Non-current liabilities	(74,223 )
Balance as of September 30, 2013	\$(102,537 )

#### 4. INTANGIBLE ASSETS

We have recorded intangible assets as a result of the METC acquisition in 2006. The carrying value of these assets was \$38.0 million and \$40.3 million (net of accumulated amortization of \$20.4 million and \$18.1 million) as of September 30, 2013 and December 31, 2012, respectively.

We have also recorded intangible assets for payments and obligations made by ITC Great Plains to certain transmission owners to acquire rights which are required under the SPP tariff to designate ITC Great Plains to build, own and operate projects within the SPP region, including the KETA Project and the Kansas V-Plan Project. The carrying amount of these intangible assets was \$11.4 million and \$8.2 million (net of accumulated amortization of \$0.4 million and \$0.3 million) as of September 30, 2013 and December 31, 2012, respectively.

During the three months ended September 30, 2013 and 2012, we recognized \$0.8 million of amortization expense of our intangible assets and \$2.4 million and \$2.3 million for the nine months ended September 30, 2013 and 2012, respectively. For each of the next five years, we expect the annual amortization of our intangible assets that have been recorded as of September 30, 2013 to be \$3.2 million per year.

#### 5. DEBT

##### Derivative Instruments and Hedging Activities

We may use derivative financial instruments, including interest rate swap contracts, to manage our exposure to fluctuations in interest rates. The use of these financial instruments mitigates exposure to these risks and the variability of our operating results. We are not a party to leveraged derivatives and do not enter into derivative financial instruments for trading or speculative purposes. In June 2013, we settled and terminated \$250.0 million and \$225.0 million of 10-year and 30-year term interest rate swaps, respectively, in conjunction with the Senior Notes issued at ITC Holdings described below. A summary of the terminated interest rate swaps is provided below:

Interest Rate Swaps	Amount	Weighted Average Fixed Rate	Gain (Loss) on Derivative	Settlement Date
(amounts in millions)				
10-year interest rate swaps	\$250.0	3.70%	\$(15.0 )	June 2013
30-year interest rate swaps	225.0	2.82%	26.2	June 2013
Total	\$475.0		\$11.2	



Table of Contents

The interest rate swaps qualified for hedge accounting treatment and the net gain of \$11.2 million was recorded net of tax in AOCI during the second quarter of 2013. This amount is being amortized as a component of interest expense over the lives of the related debt.

ITC Holdings

Term Loan Credit Agreement

On February 15, 2013, ITC Holdings entered into an unsecured, unguaranteed term loan credit agreement (the “2013 Term Loan”), due December 31, 2013, under which ITC Holdings originally borrowed the maximum of \$250.0 million available under the agreement. As of September 30, 2013, ITC Holdings had \$160.0 million outstanding under the 2013 Term Loan and no further borrowings are permitted thereunder. The proceeds from the 2013 Term Loan were used for general corporate purposes, including the repayment of borrowings under the ITC Holdings’ revolving credit agreement. The weighted average interest rate on the borrowings outstanding under the 2013 Term Loan was 1.2% at September 30, 2013.

Senior Unsecured Notes

On July 3, 2013, ITC Holdings issued \$250.0 million aggregate principal amount of its 4.05% Senior Notes, due July 1, 2023 and \$300.0 million aggregate principal amount of its 5.30% Senior Notes, due July 1, 2043. The proceeds from these issuances were used to repay its \$267.0 million of 5.25% Senior Notes due July 15, 2013, the \$200.0 million borrowed under an unsecured, unguaranteed term loan credit agreement entered into in 2012, a portion of the amount borrowed under the 2013 Term Loan and for general corporate purposes.

ITC Midwest

On April 4, 2013, ITC Midwest issued \$100.0 million aggregate principal amount of 4.09% First Mortgage Bonds, Series F, due April 30, 2043. The proceeds from the issuance were used to refinance existing indebtedness, partially fund capital expenditures and for general corporate purposes. ITC Midwest’s First Mortgage Bonds are issued under its First Mortgage and Deed of Trust and secured by a first mortgage lien on substantially all of ITC Midwest’s property.

ITC Great Plains

On May 30, 2013, ITC Great Plains entered into a new unsecured, unguaranteed term loan credit agreement due November 28, 2014, under which ITC Great Plains had borrowed the maximum \$100.0 million as of September 30, 2013. The proceeds were used to refinance existing indebtedness, fund capital expenditures and for general corporate purposes. The weighted average interest rate on the borrowings outstanding under the term loan was 1.0% at September 30, 2013.

ITCTransmission

Term Loan Credit Agreement

On July 11, 2013, ITCTransmission entered into a new unsecured, unguaranteed term loan credit agreement due July 14, 2014, under which ITCTransmission borrowed the maximum of \$185.0 million upon entering the agreement. The proceeds were used to repay its \$185.0 million of 4.45% First Mortgage Bonds, Series A, due July 15, 2013. This borrowing was repaid in full as of September 30, 2013.

First Mortgage Bonds

On August 14, 2013, ITCTransmission issued \$285.0 million aggregate principal amount of 4.625% First Mortgage Bonds, Series E, due August 15, 2043. The proceeds from the issuance were used to repay its term loan credit agreement of \$185.0 million and \$100.0 million outstanding under an intercompany advance agreement between ITCTransmission and ITC Holdings. ITCTransmission’s First Mortgage Bonds are issued under its First Mortgage and Deed of Trust and secured by a first mortgage lien on substantially all of ITCTransmission’s property.



Table of Contents

## Revolving Credit Agreements

At September 30, 2013, ITC Holdings and its Regulated Operating Subsidiaries had the following unsecured revolving credit facilities available, each of which bears interest at a variable rate based on the prime rate or LIBOR (subject to adjustment based on credit rating):

(amounts in millions)	Total Available Capacity	Outstanding Balance (a)	Unused Capacity	Weighted Average Interest Rate on Outstanding Balance	Commitment Fee Rate (b)	Original Term	Date of Maturity
Revolving Credit Agreements:							
ITC Holdings	\$200.0	\$—	\$200.0	n/a	(c) 0.25	% 5 years	May 2016
ITC Transmission	100.0	28.3	71.7	1.3%	0.125	% 5 years	May 2016
METC	100.0	54.4	45.6	1.3%	0.125	% 5 years	May 2016
ITC Midwest	175.0	94.7	80.3	1.2%	0.10	% 5 years	May 2017
ITC Great Plains	150.0	36.7	113.3	1.9%	0.30	% 4 years	February 2015
Total	\$725.0	\$214.1	\$510.9				

(a) Included within long-term debt.

(b) Calculation based on the average daily unused commitments, subject to adjustment based on the borrower's credit rating.

Loan bears interest at a rate equal to LIBOR plus an applicable margin of 1.75% or at a base rate, which is defined (c) as the higher of the prime rate, 0.50% above the federal funds rate or 1% above the one month LIBOR, plus an applicable margin of 0.75%, subject to adjustments based on ITC Holdings' credit rating.

## Covenants

Our debt instruments contain numerous financial and operating covenants that place significant restrictions on certain transactions, such as incurring additional indebtedness, engaging in sale and lease-back transactions, creating liens or other encumbrances, entering into mergers, consolidations, liquidations or dissolutions, creating or acquiring subsidiaries, selling or otherwise disposing of all or substantially all of our assets and paying dividends. In addition, the covenants require us to meet certain financial ratios, such as maintaining certain debt to capitalization ratios and maintaining certain interest coverage ratios. We are currently in compliance with all debt covenants.

## 6. STOCKHOLDERS' EQUITY

The changes in stockholders' equity for the nine months ended September 30, 2013 were as follows:

(in thousands, except share and per share data)	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount			
BALANCE, DECEMBER 31, 2012	52,248,514	\$989,334	\$443,569	\$(18,048)	\$1,414,855
Net income	—	—	156,569	—	156,569
Repurchase and retirement of common stock	(50,388)	(4,508)	—	—	(4,508)
Dividends declared on common stock (\$1.18 per share)	—	—	(61,821)	—	(61,821)
Stock option exercises	143,514	6,860	—	—	6,860
Shares issued under the Employee Stock Purchase Plan	19,024	1,353	—	—	1,353
Issuance of restricted stock	121,811	—	—	—	—
Forfeiture of restricted stock	(11,121)	—	—	—	—
Share-based compensation, net of forfeitures	—	10,670	—	—	10,670
Other comprehensive income, net of tax	—	—	—	24,555	24,555

Edgar Filing: ITC Holdings Corp. - Form 10-Q

BALANCE, SEPTEMBER 30, 2013	52,471,354	\$1,003,709	\$538,317	\$6,507	\$1,548,533
-----------------------------	------------	-------------	-----------	---------	-------------

12

---

Table of Contents

The changes in stockholders' equity for the nine months ended September 30, 2012 were as follows:

	Common Stock		Retained	Accumulated	Total
(in thousands, except share and per share data)	Shares	Amount	Earnings	Other Comprehensive Loss	Stockholders' Equity
BALANCE, DECEMBER 31, 2011	51,323,368	\$943,444	\$330,816	\$(15,368 )	\$1,258,892
Net income	—	—	139,620	—	139,620
Repurchase and retirement of common stock	(69,183 )	(4,896 )	—	—	(4,896 )
Dividends declared on common stock (\$1.0825 per share)	—	—	(55,677 )	—	(55,677 )
Stock option exercises	108,693	3,796	—	—	3,796
Shares issued under the Employee Stock Purchase Plan	18,107	1,133	—	—	1,133
Issuance of restricted stock	153,381	—	—	—	—
Forfeiture of restricted stock	(9,929 )	—	—	—	—
Share-based compensation, net of forfeitures	—	11,378	—	—	11,378
Other	—	403	—	—	403
Other comprehensive loss, net of tax	—	—	—	(5,440 )	(5,440 )
BALANCE, SEPTEMBER 30, 2012	51,524,437	\$955,258	\$414,759	\$(20,808 )	\$1,349,209

## Accumulated Other Comprehensive Income

The following table provides the components of changes in AOCI for the three and nine months ended September 30, 2013 and 2012:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Balance at the beginning of period	\$6,310	\$(19,492 )	\$(18,048 )	\$(15,368 )
Derivative instruments				
Reclassification of gain relating to interest rate cash flow hedges from AOCI (net of tax of \$71 and \$9 for the three months ended September 30, 2013 and 2012, respectively, and net of tax of \$90 and \$21 for the nine months ended September 30, 2013 and 2012, respectively) (a)	110	15	139	52
Gain (loss) on interest rate swaps relating to interest rate cash flow hedges (net of tax of \$862 for the three months ended September 30, 2012 and net of tax of \$15,652 and \$3,545 for the nine months ended September 30, 2013 and 2012, respectively)	—	(1,331 )	24,329	(5,492 )
Derivative instruments, net of tax	110	(1,316 )	24,468	(5,440 )
Available-for-sale securities				
Unrealized gain on available-for-sale securities (net of tax of \$56 for the three and nine months ended September 30, 2013)	87	—	87	—
Available-for-sale securities, net of tax	87	—	87	—
Total other comprehensive income (loss), net of tax	197	(1,316 )	24,555	(5,440 )
Balance at the end of period	\$6,507	\$(20,808 )	\$6,507	\$(20,808 )

(a) Reclassified from AOCI to interest expense — net.



Table of Contents

ITC Holdings Sales Agency Financing Agreement

On July 27, 2011, ITC Holdings entered into a Sales Agency Financing Agreement with Deutsche Bank Securities Inc. as sales agent (the "SAFA"). Under the terms of the SAFA, ITC Holdings may issue and sell shares of common stock, without par value, from time to time, up to an aggregate sales proceeds amount of \$250.0 million. The SAFA terminates in July 2014. The agreements relating to the Entergy Transaction generally prohibit us from issuing shares under the SAFA until approximately two years after the closing except under certain limited circumstances. The shares of common stock may be offered in one or more selling periods. Any shares of common stock sold under the SAFA will be offered at market prices prevailing at the time of sale. Moreover, ITC Holdings will specify to the sales agent (i) the aggregate selling price of the shares of common stock to be sold during each selling period, and (ii) the minimum price below which sales may not be made. ITC Holdings will pay a commission equal to a mutually agreed upon rate with its agent, not to exceed 2% of the sales price of all shares of common stock sold through its agent under the SAFA, plus expenses. The shares we would issue under the SAFA have been registered under ITC Holdings' shelf registration statement on Form S-3 (File No. 333-187994) filed on April 18, 2013 with the SEC. No shares have been issued under the SAFA as of September 30, 2013.

7. SHARE-BASED COMPENSATION

Long-Term Incentive Plan Grants

On May 14, 2013, pursuant to the Second Amended and Restated 2006 Long-Term Incentive Plan, we granted 310,111 options to purchase shares of our common stock with an exercise price of \$87.93 per share, which was the closing price of our common stock on the date of grant. The options vest in three equal annual installments with the first installment vesting on May 14, 2014. In addition, on May 14, 2013, we granted 104,177 shares of restricted stock at a fair value of \$87.93 per share. Holders of restricted stock have all the rights of a holder of common stock of ITC Holdings, including dividend and voting rights. The restricted stock vests three years after the grant date. The holder of the restricted stock may not sell, transfer or pledge their shares of restricted stock until vesting occurs.

Stock Option Exercises

We issued 143,514 and 851,720 shares of our common stock during the nine months ended September 30, 2013 and the year ended December 31, 2012, respectively, due to the exercise of stock options.

Table of Contents

## 8. EARNINGS PER SHARE

We report both basic and diluted earnings per share. Our restricted stock and deferred stock units contain rights to receive nonforfeitable dividends and thus, are participating securities requiring the two-class method of computing earnings per share. A reconciliation of both calculations for the three and nine months ended September 30, 2013 and 2012 is presented in the following table:

(in thousands, except share, per share data and percentages)	Three months ended September 30,		Nine months ended September 30,		
	2013	2012	2013	2012	
Numerator:					
Net income	\$58,984	\$51,183	\$156,569	\$139,620	
Less: dividends declared — common and restricted shares	(22,299 )	(19,446 )	(61,820 )	(55,684 )	
Undistributed earnings	36,685	31,737	94,749	83,936	
Percentage allocated to common shares (a)	99.1	% 98.7	% 99.0	% 98.7	%
Undistributed earnings — common shares	36,355	31,324	93,802	82,845	
Add: dividends declared — common shares	22,098	19,213	61,240	54,971	
Numerator for basic and diluted earnings per common share	\$58,453	\$50,537	\$155,042	\$137,816	
Denominator:					
Denominator for basic earnings per common share — weighted average common shares outstanding	51,986,293	50,863,727	51,875,787	50,748,257	
Incremental shares for stock options and employee stock purchase plan	435,798	745,972	417,144	754,437	
Denominator for diluted earnings per common share — adjusted weighted average shares and assumed conversion	52,422,091	51,609,699	52,292,931	51,502,694	
Per common share net income:					
Basic	\$1.12	\$0.99	\$2.99	\$2.72	
Diluted	\$1.12	\$0.98	\$2.96	\$2.68	
<hr/>					
(a) Weighted average common shares outstanding	51,986,293	50,863,727	51,875,787	50,748,257	
Weighted average restricted shares (participating securities)	476,177	644,233	499,573	677,070	
Total	52,462,470	51,507,960	52,375,360	51,425,327	
Percentage allocated to common shares	99.1	% 98.7	% 99.0	% 98.7	%

The incremental shares for stock options and the employee stock purchase plan (“ESPP”) are included in the diluted earnings per share calculation using the treasury stock method, unless the effect of including them would be anti-dilutive. The outstanding stock options and ESPP shares and the anti-dilutive stock options and ESPP shares excluded from the diluted earnings per share calculations were as follows:

	2013	2012
Outstanding stock options and ESPP shares (as of September 30)	1,746,100	2,344,578
Anti-dilutive stock options and ESPP shares (for the three and nine months ended September 30)	305,634	565,956

Table of Contents

## 9. RETIREMENT BENEFITS AND ASSETS HELD IN TRUST

## Retirement Plan Benefits

We have a qualified retirement plan for eligible employees, comprised of a traditional final average pay plan and a cash balance plan. The traditional final average pay plan is noncontributory, covers select employees, and provides retirement benefits based on the employees' years of benefit service, average final compensation and age at retirement. The cash balance plan is also noncontributory, covers substantially all employees, and provides retirement benefits based on eligible compensation and interest credits. While we are obligated to fund the retirement plan by contributing the minimum amount required by the Employee Retirement Income Security Act of 1974, as amended, it is our practice to contribute the maximum allowable amount as defined by section 404 of the Internal Revenue Code. We contributed \$6.9 million to the defined benefit retirement plan relating to the 2012 plan year in June 2013.

We also have two supplemental nonqualified, noncontributory, retirement benefit plans for selected management employees. The plans provide for benefits that supplement those provided by our other retirement plans. We contributed \$0.6 million to these supplemental nonqualified, noncontributory, retirement benefit plans in June 2013. We do not expect to make any additional contributions with respect to these plans in 2013.

Net pension cost includes the following components:

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Service cost	\$1,315	\$1,040	\$3,946	\$3,120
Interest cost	698	647	2,094	1,942
Expected return on plan assets	(717	) (569	) (2,151	) (1,708
Amortization of prior service cost	(10	) (11	) (31	) (32
Amortization of unrecognized loss	679	868	2,036	2,603
Net pension cost	\$1,965	\$1,975	\$5,894	\$5,925

## Other Postretirement Benefits

We provide certain postretirement health care, dental, and life insurance benefits for employees who may become eligible for these benefits. We contributed \$1.0 million to the postretirement benefit plan in September 2013. We expect to contribute up to an additional \$1.5 million to the postretirement benefit plan in 2013.

Net postretirement cost includes the following components:

(in thousands)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Service cost	\$1,443	\$1,358	\$4,330	\$4,075
Interest cost	390	388	1,171	1,164
Expected return on plan assets	(353	) (254	) (1,061	) (762
Amortization of prior service cost	—	31	—	93
Amortization of unrecognized loss	55	134	165	401
Net postretirement cost	\$1,535	\$1,657	\$4,605	\$4,971

## Defined Contribution Plan

We also sponsor a defined contribution retirement savings plan. Participation in this plan is available to substantially all employees. We match employee contributions up to certain predefined limits based upon eligible compensation and the employee's contribution rate. The cost of this plan was \$0.7 million for the three months ended September 30, 2013 and 2012, and \$3.1 million and \$2.4 million for the nine months ended September 30, 2013 and 2012, respectively.





Table of Contents

## 10. FAIR VALUE MEASUREMENTS

The measurement of fair value is based on a three-tier hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Our assets measured at fair value subject to the three-tier hierarchy at September 30, 2013, were as follows:

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)			
Financial assets measured on a recurring basis:			
Cash and cash equivalents — cash equivalents	\$13,452	\$51,446	\$—
Mutual funds — fixed income securities	20,997	—	—
Mutual funds — equity securities	673	—	—
Total	\$35,122	\$51,446	\$—

Our assets and liabilities measured at fair value subject to the three-tier hierarchy at December 31, 2012, were as follows:

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)			
Financial assets measured on a recurring basis:			
Cash and cash equivalents — cash equivalents	\$13,127	\$10,037	\$—
Mutual funds — fixed income securities	21,332	—	—
Mutual funds — equity securities	1,612	—	—
Interest rate swap derivatives	—	2,725	—
Financial liabilities measured on a recurring basis:			
Interest rate swap derivatives	—	(31,507)	—
Total	\$36,071	\$(18,745)	\$—

As of September 30, 2013 and December 31, 2012, we held certain assets and liabilities that are required to be measured at fair value on a recurring basis. The assets consist of investments recorded within cash and cash equivalents and other long-term assets, including investments held in a trust associated with our supplemental nonqualified, noncontributory, retirement benefit plans for selected management employees. Our Level 1 investments included in cash and cash equivalents consist of money market mutual funds and common and collective trusts that are administered similar to money market funds recorded at cost plus accrued interest to approximate fair value. Our mutual funds consist primarily of publicly traded mutual funds for which market prices are readily available. Changes in the observed trading prices and liquidity of money market funds are monitored as additional support for determining fair value, and losses are recorded in earnings if fair value falls below recorded cost. The cash and cash equivalents that are classified as a Level 2 investment consist of deposits held with financial institutions that are then invested by the financial institution in money market mutual funds and common and collective trusts that are administered similar to money market funds. The underlying money market funds and common and collective trusts are recorded at cost plus accrued interest.

The assets and liabilities related to derivatives consisted of interest rate swaps discussed in Note 5. The fair value of our interest rate swap derivatives as of December 31, 2012 was determined based on a discounted cash flow method

using LIBOR swap rates which are observable at commonly quoted intervals. In June 2013, we settled and terminated all outstanding derivatives.

We also held non-financial assets that are required to be measured at fair value on a non-recurring basis. These consist of goodwill and intangible assets. We did not record any impairment charges on long-lived assets and no other significant events occurred requiring non-financial assets and liabilities to be measured at fair value (subsequent to initial recognition) during the nine months ended September 30, 2013. For additional information on our goodwill and intangible assets, please refer to the notes to the consolidated financial statements as of and for the year ended December 31, 2012 included in our Form 10-K for such period and to Note 4 of this Form 10-Q.

Table of Contents

Fair Value of Financial Assets and Liabilities

Fixed Rate Debt

Based on the borrowing rates obtained from third party lending institutions currently available for bank loans with similar terms and average maturities from active markets, the fair value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,377.0 million and \$3,072.9 million at September 30, 2013 and December 31, 2012, respectively. These fair values represent Level 2 under the three-tier hierarchy described above. The total book value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,100.8 million and \$2,619.4 million at September 30, 2013 and December 31, 2012, respectively.

Revolving and Term Loan Credit Agreements

At September 30, 2013 and December 31, 2012, we had a consolidated total of \$474.1 million and \$527.8 million, respectively, outstanding under our revolving and term loan credit agreements, which are variable rate loans. The fair value of these loans approximates book value based on the borrowing rates currently available for variable rate loans obtained from third party lending institutions. These fair values represent Level 2 under the three-tier hierarchy described above.

11. COMMITMENTS AND CONTINGENT LIABILITIES

Environmental Matters

Our Regulated Operating Subsidiaries' operations are subject to federal, state, and local environmental laws and regulations, which impose limitations on the discharge of pollutants into the environment, establish standards for the management, treatment, storage, transportation and disposal of hazardous materials and of solid and hazardous wastes, and impose obligations to investigate and remediate contamination in certain circumstances. Liabilities to investigate or remediate contamination, as well as other liabilities concerning hazardous materials or contamination, such as claims for personal injury or property damage, may arise at many locations, including formerly owned or operated properties and sites where wastes have been treated or disposed of, as well as at properties currently owned or operated by our Regulated Operating Subsidiaries. Such liabilities may arise even where the contamination does not result from noncompliance with applicable environmental laws. Under a number of environmental laws, such liabilities may also be joint and several, meaning that a party can be held responsible for more than its share of the liability involved, or even the entire share. Although environmental requirements generally have become more stringent and compliance with those requirements more expensive, we are not aware of any specific developments that would increase our Regulated Operating Subsidiaries' costs for such compliance in a manner that would be expected to have a material adverse effect on our results of operations, financial position or liquidity.

Our Regulated Operating Subsidiaries' assets and operations also involve the use of materials classified as hazardous, toxic or otherwise dangerous. Many of the properties our Regulated Operating Subsidiaries own or operate have been used for many years, and include older facilities and equipment that may be more likely than newer ones to contain or be made from such materials. Some of these properties include aboveground or underground storage tanks and associated piping. Some of them also include large electrical equipment filled with mineral oil, which may contain or previously have contained PCBs. Our Regulated Operating Subsidiaries' facilities and equipment are often situated close to or on property owned by others so that, if they are the source of contamination, other's property may be affected. For example, aboveground and underground transmission lines sometimes traverse properties that our Regulated Operating Subsidiaries do not own, and, at some of our Regulated Operating Subsidiaries' transmission stations, transmission assets (owned or operated by our Regulated Operating Subsidiaries) and distribution assets (owned or operated by our Regulated Operating Subsidiaries' transmission customer) are commingled.

Some properties in which our Regulated Operating Subsidiaries have an ownership interest or at which they operate are, and others are suspected of being, affected by environmental contamination. Our Regulated Operating Subsidiaries are not aware of any pending or threatened claims against them with respect to environmental contamination, or of any investigation or remediation of contamination at any properties, that entail costs likely to materially affect them. Some facilities and properties are located near environmentally sensitive areas such as wetlands.

Claims have been made or threatened against electric utilities for bodily injury, disease or other damages allegedly related to exposure to electromagnetic fields associated with electric transmission and distribution lines. While our Regulated Operating Subsidiaries do not believe that a causal link between electromagnetic field exposure and injury has been generally established and accepted in the scientific community, if such a relationship is established or accepted, the liabilities and costs imposed on our business could be significant. We are not aware of any pending or threatened claims against our Regulated

Table of Contents

Operating Subsidiaries for bodily injury, disease or other damages allegedly related to exposure to electromagnetic fields and electric transmission and distribution lines that entail costs likely to have a material adverse effect on our results of operations, financial position or liquidity.

Litigation

We are involved in certain legal proceedings before various courts, governmental agencies and mediation panels concerning matters arising in the ordinary course of business. These proceedings include certain contract disputes, regulatory matters and pending judicial matters. We cannot predict the final disposition of such proceedings. We regularly review legal matters and record provisions for claims that are considered probable of loss. The resolution of pending proceedings is not expected to have a material effect on our operations or consolidated financial statements in the period in which they are resolved.

Michigan Sales and Use Tax Audit

The Michigan Department of Treasury conducted a sales and use tax audit of ITCTransmission for the audit period April 1, 2005 through June 30, 2008 and has denied ITCTransmission's use of the industrial processing exemption from use tax it has taken beginning January 1, 2007. ITCTransmission has certain administrative and judicial appeal rights.

ITCTransmission believes that its utilization of the industrial processing exemption is appropriate and intends to defend itself against the denial of such exemption. However, it is reasonably possible that the assessment of additional use tax could be sustained after all administrative appeals and litigation have been exhausted.

The amount of the potential use tax liability associated with the exemptions taken by ITCTransmission through September 30, 2013 is estimated to be approximately \$18.0 million, which includes approximately \$3.8 million assessed for the audit period April 1, 2005 through June 30, 2008, including interest. ITCTransmission has not recorded this contingent liability as of September 30, 2013. However, in the event it becomes appropriate to record additional use tax liability relating to this matter, ITCTransmission would record the additional use tax primarily as an increase to the cost of property, plant and equipment, as the majority of purchases for which the exemption was taken relate to equipment purchases associated with capital projects. METC has also taken the industrial processing exemption, estimated to be approximately \$11.2 million for periods still subject to audit, however, METC has not recorded any contingent liabilities as of September 30, 2013 associated with this matter. These higher use tax expenses would be passed on to ITCTransmission's and METC's customers as the amounts are included as components of net revenue requirements and resulting rates.

FERC Audit of ITC Midwest

Certain staff of the FERC ("FERC audit staff") have conducted an audit of ITC Midwest's compliance with certain of the FERC's regulations and the conditions established in the 2007 FERC order approving the acquisition of the transmission assets of IP&L by ITC Midwest. In 2011, the FERC issued an order that identified certain findings and recommendations of FERC audit staff relating to specific aspects of the accounting treatment for the acquisition that requires adjustments to ITC Midwest's annual revenue requirement calculations and corresponding refunds. In 2012, ITC Midwest filed a refund report with the FERC which included adjustments to ITC Midwest's annual revenue requirement calculations and corresponding refunds. On January 30, 2013, the FERC accepted ITC Midwest's refund report which included the amount to be refunded in 2014.

ITCTransmission and METC had applied an accounting treatment for their respective acquisitions similar to ITC Midwest, and on February 1, 2013, voluntarily filed compliance plans with FERC to address the findings raised with respect to the ITC Midwest audit. On July 5, 2013, the FERC accepted ITCTransmission's and METC's refund reports which included the amounts to be refunded in 2014.

ITC Midwest, ITCTransmission and METC have recorded an aggregate regulatory liability for the refund and related interest of \$13.0 million and \$12.7 million as of September 30, 2013 and December 31, 2012, respectively, in the condensed consolidated statements of financial position. The refund amounts are limited to 2010 and earlier periods.

ITC Midwest Project Commitment

In the Minnesota regulatory proceeding to approve ITC Midwest's December 2007 acquisition of the transmission assets of IP&L, ITC Midwest agreed to build a certain project in Iowa, the 345 kV Salem-Hazelton line, and made a commitment to use commercially reasonable best efforts to complete the project prior to December 31, 2011. In the

event ITC Midwest is found to have failed to meet this commitment, the allowed 12.38% rate of return on the actual equity portion of its capital structure would be reduced to 10.39% until such time as ITC Midwest completes the project, and ITC Midwest would refund

Table of Contents

with interest any amounts collected since the close date of the transaction that exceeded what would have been collected if the 10.39% return on equity had been used. Certain regulatory approvals were needed from the Iowa Utilities Board (“IUB”) before construction of the project could commence, but due to the IUB’s case schedule, these approvals were not received until the second quarter of 2011. As a result of the delay in the receipt of the necessary regulatory approvals, the project was not completed by December 31, 2011. We have notified the Minnesota Public Utilities Commission that the Salem-Hazleton line was placed into service on April 25, 2013, and requested confirmation from the commission that ITC Midwest has satisfied its commitment and that no refund is due as a result of the project not being completed by December 31, 2011. We believe we used commercially reasonable best efforts to meet the December 31, 2011 deadline, and therefore, we believe the likelihood of any material effect on the financial statements from this matter is remote.

**12. ENTERGY TRANSACTION**

As of December 4, 2011, Entergy and ITC Holdings executed definitive agreements (as subsequently amended, the “transaction agreements”) under which Entergy will divest and then merge its electric transmission business with a wholly-owned subsidiary of ITC Holdings (“Entergy Transaction”). Entergy’s electric transmission business consists of approximately 15,400 miles of interconnected transmission lines at voltages of 69 kV and above and associated substations across its utility service territory in the Mid-South.

The terms of the transaction agreements call for Entergy to divest its electric transmission business to a newly-formed entity, Mid South TransCo LLC (“Mid South TransCo”), and Mid South TransCo’s subsidiaries, and distribute the equity interests in Mid South TransCo to Entergy’s shareholders in the form of a tax-free spin-off or split-off exchange offer or a combination of both. Mid South TransCo will then merge with a newly-created merger subsidiary of ITC Holdings in an all-stock, Reverse Morris Trust transaction, and will survive the merger as a wholly-owned subsidiary of ITC Holdings. Prior to the merger, we expect to effectuate a recapitalization, which may take the form of a one-time special dividend to ITC Holdings’ pre-merger shareholders, a repurchase of ITC Holdings common stock from its shareholders, or a combination of a special dividend and share repurchase. The merger would result in shareholders of Entergy receiving approximately 50.1% of the shares of ITC Holdings outstanding immediately following the merger in exchange for their shares of Mid South TransCo, with the shareholders of ITC Holdings immediately prior to the merger owning the remaining approximately 49.9% equity interest in the combined company immediately after the merger. In addition, Entergy would receive gross cash proceeds of \$1.775 billion from indebtedness that would be incurred by Mid South TransCo and its subsidiaries prior to the merger and assumed under the acquisition. On April 16, 2013 and June 20, 2013, ITC Holdings received the shareholder approval and FERC approval, respectively, necessary to consummate the merger. In addition, Entergy has received a favorable ruling on the tax free nature of the transaction from the Internal Revenue Service. Completion of the transaction is not expected prior to 2014 and is subject to the satisfaction of certain other closing conditions, including the receipt of necessary approvals of Entergy’s retail regulators.

For the three months ended September 30, 2013 and 2012, we expensed external legal, advisory and financial services fees related to the Entergy Transaction of \$7.2 million and \$5.6 million, respectively, and \$34.9 million and \$12.1 million for the nine months ended September 30, 2013 and 2012, respectively. For each of the three months ended September 30, 2013 and 2012, we expensed certain internal labor and associated costs related to the Entergy Transaction of \$1.9 million, and we expensed \$7.1 million and \$5.4 million for the nine months ended September 30, 2013 and 2012, respectively. The external and internal costs related to the Entergy Transaction were not included as components of revenue requirement at our Regulated Operating Subsidiaries as they were incurred at ITC Holdings. Under the terms of the transaction agreements, prior to completion of the Entergy Transaction, there are certain restrictions on our ability to pay dividends other than those paid in the ordinary course of business with record dates and payment dates consistent with our past practice and, if elected, a one-time special dividend to ITC Holdings’ pre-merger shareholders in accordance with the transaction agreements. Management does not expect the restrictions to have an impact on our ability to pay dividends at the current level in the foreseeable future.





Table of Contents

## 13. SEGMENT INFORMATION

We identify reportable segments based on the criteria set forth by the FASB regarding disclosures about segments of an enterprise, including the regulatory environment of our subsidiaries and the business activities performed to earn revenues and incur expenses. The following tables show our financial information by reportable segment:

	Three months ended		Nine months ended	
	September 30,		September 30,	
(in thousands)	2013	2012	2013	2012
<b>OPERATING REVENUES:</b>				
Regulated Operating Subsidiaries	\$238,857	\$214,821	\$686,128	\$608,950
ITC Holdings and other	152	151	455	455
Intercompany eliminations	(227 )	(171 )	(680 )	(516 )
Total Operating Revenues	\$238,782	\$214,801	\$685,903	\$608,889
	Three months ended		Nine months ended	
	September 30,		September 30,	
(in thousands)	2013	2012	2013	2012
<b>INCOME BEFORE INCOME TAXES:</b>				
Regulated Operating Subsidiaries	\$131,939	\$111,849	\$376,398	\$307,067
ITC Holdings and other	(38,267 )	(32,328 )	(124,477 )	(90,756 )
Total Income Before Income Taxes	\$93,672	\$79,521	\$251,921	\$216,311
	Three months ended		Nine months ended	
	September 30,		September 30,	
(in thousands)	2013	2012	2013	2012
<b>NET INCOME:</b>				
Regulated Operating Subsidiaries	\$82,291	\$69,537	\$234,168	\$190,576
ITC Holdings and other	58,984	51,183	156,569	139,620
Intercompany eliminations	(82,291 )	(69,537 )	(234,168 )	(190,576 )
Total Net Income	\$58,984	\$51,183	\$156,569	\$139,620
<b>TOTAL ASSETS:</b>			September 30,	December
(in thousands)			2013	31,
Regulated Operating Subsidiaries			\$6,028,346	\$5,440,401
ITC Holdings and other			3,556,794	3,252,047
Reconciliations / Intercompany eliminations (a)			(3,412,740 )	(3,127,639 )
Total Assets			\$6,172,400	\$5,564,809

Reconciliation of total assets results primarily from differences in the netting of deferred tax assets and liabilities at (a) our Regulated Operating Subsidiaries as compared to the classification in our condensed consolidated statements of financial position.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Our reports, filings and other public announcements contain certain statements that describe our management's beliefs concerning future business conditions, plans and prospects, growth opportunities and the outlook for our business and the electric transmission industry based upon information currently available. Such statements are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. Wherever possible, we have identified these forward-looking statements by words such as "will," "may," "anticipates," "believes," "intends," "estimates," "expects," "projects" and similar phrases. These forward-looking statements are based upon assumptions our management believes are reasonable. Such forward-looking statements are subject to risks and uncertainties which could cause our actual results, performance and achievements to differ materially from those expressed in, or implied by, these statements, including, among others, the risks and uncertainties listed in Item 1A Risk Factors of our Form 10-K for the fiscal year ended December 31, 2012, and the following:

Certain elements of our Regulated Operating Subsidiaries' cost recovery through rates can be challenged, which could result in lowered rates and/or refunds of amounts previously collected and thus have an adverse effect on our business, financial condition, results of operations and cash flows. We have also made certain commitments to federal and state regulators with respect to, among other things, our rates in connection with acquisitions that could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our Regulated Operating Subsidiaries' actual capital expenditures may be lower than planned, which would decrease expected rate base and therefore our expected revenues and earnings. In addition, we expect to invest in strategic development opportunities to improve the efficiency and reliability of the transmission grid, but we cannot assure you that we will be able to initiate or complete any of these investments.

The regulations to which we are subject may limit our ability to raise capital and/or pursue acquisitions, development opportunities or other transactions or may subject us to liabilities.

Changes in federal energy laws, regulations or policies could impact our business, financial condition, results of operations and cash flows.

If amounts billed for transmission service for our Regulated Operating Subsidiaries' transmission systems are lower than expected, or our actual revenue requirements are higher than expected, the timing of collection of our revenues would be delayed.

Each of our MISO Regulated Operating Subsidiaries depends on its primary customer for a substantial portion of its revenues, and any material failure by those primary customers to make payments for transmission services could have a material adverse effect on our business, financial condition, results of operations and cash flows.

A significant amount of the land on which our Regulated Operating Subsidiaries' assets are located is subject to easements, mineral rights and other similar encumbrances. As a result, our Regulated Operating Subsidiaries must comply with the provisions of various easements, mineral rights and other similar encumbrances, which may adversely impact their ability to complete construction projects in a timely manner.

Our Regulated Operating Subsidiaries contract with third parties to provide services for certain aspects of their businesses. If any of these agreements are terminated, our Regulated Operating Subsidiaries may face a shortage of labor or replacement contractors to provide the services formerly provided by these third parties.

Hazards associated with high-voltage electricity transmission may result in suspension of our Regulated Operating Subsidiaries' operations or the imposition of civil or criminal penalties.

Our Regulated Operating Subsidiaries are subject to environmental regulations and to laws that can give rise to substantial liabilities from environmental contamination.

Our Regulated Operating Subsidiaries are subject to various regulatory requirements, including reliability standards; contract filing requirements; reporting, recordkeeping and accounting requirements; and transaction approval requirements. Violations of these requirements, whether intentional or unintentional, may result in penalties that, under some circumstances, could have a material adverse effect on our business, financial condition, results of operations and cash flows.



Table of Contents

Acts of war, terrorist attacks and threats, including cyber attacks or threats, or the escalation of military activity in response to such attacks or otherwise may negatively affect our business, financial condition, results of operations and cash flows.

ITC Holdings is a holding company with no operations, and unless we receive dividends or other payments from our subsidiaries, we may be unable to pay dividends and fulfill our other cash obligations.

We are highly leveraged and our dependence on debt may limit our ability to fulfill our debt obligations and/or to obtain additional financing.

Certain provisions in our debt instruments limit our financial flexibility.

Adverse changes in our credit ratings may negatively affect us.

Provisions in our Articles of Incorporation and bylaws, Michigan corporate law and our debt agreements may impede efforts by our shareholders to change the direction or management of our company.

Provisions in our Articles of Incorporation restrict market participants from voting or owning 5% or more of the outstanding shares of our capital stock.

- We may be unable to satisfy the conditions or obtain the approvals required to complete the Entergy Transaction or such approvals may contain material restrictions or conditions.

If completed, the Entergy Transaction may not be successful or achieve its anticipated benefits.

The merger agreement contains provisions that may discourage other companies from trying to acquire us.

- Failure to complete the Entergy Transaction could adversely affect the market price of ITC Holdings common stock as well as our business, financial condition, results of operations and cash flows.

Investors holding shares of ITC Holdings common stock immediately prior to the completion of the Entergy

Transaction will, in the aggregate, have a significantly reduced ownership and voting interest in us after the Entergy Transaction and will exercise less influence over management.

After the completion of the merger, sales of ITC Holdings common stock may negatively affect its market price.

We are required to abide by potentially significant restrictions which could limit our ability to undertake certain corporate actions (such as the issuance of ITC Holdings common stock or the undertaking of a merger or consolidation) that otherwise could be advantageous.

Because our forward-looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond our control or are subject to change, actual results could be materially different and any or all of our forward-looking statements may turn out to be wrong. Forward-looking statements speak only as of the date made and can be affected by assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this report will be important in determining future results. Consequently, we cannot assure you that our expectations or forecasts expressed in such forward-looking statements will be achieved. Except as required by law, we undertake no obligation to publicly update any of our forward-looking or other statements, whether as a result of new information, future events, or otherwise.

OVERVIEW

Through our Regulated Operating Subsidiaries, we operate high-voltage systems in Michigan's Lower Peninsula and portions of Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma that transmit electricity from generating stations to local distribution facilities connected to our systems. Our business strategy is to operate, maintain and invest in transmission infrastructure in order to enhance system integrity and reliability, to reduce transmission constraints and to upgrade the transmission networks to support new generating resources interconnecting to our transmission systems. We also are pursuing development projects not within our existing systems, which are also intended to improve overall grid reliability, reduce transmission constraints and facilitate interconnections of new generating resources, as well as enhance competitive wholesale electricity markets.

Table of Contents

As electric transmission utilities with rates regulated by the FERC, our Regulated Operating Subsidiaries earn revenues through tariff rates charged for the use of their electric transmission systems by our customers, which include investor-owned utilities, municipalities, cooperatives, power marketers and alternative energy suppliers. As independent transmission companies, our Regulated Operating Subsidiaries are subject to rate regulation only by the FERC. The rates charged by our Regulated Operating Subsidiaries are established using cost-based formula rate templates as discussed in Note 3 to the condensed consolidated financial statements under “— Cost-Based Formula Rates with True-Up Mechanism.”

Our Regulated Operating Subsidiaries’ primary operating responsibilities include maintaining, improving and expanding their transmission systems to meet their customers’ ongoing needs, scheduling outages on system elements to allow for maintenance and construction, maintaining appropriate system voltages and monitoring flows over transmission lines and other facilities to ensure physical limits are not exceeded.

We derive nearly all of our revenues from providing electric transmission service over our Regulated Operating Subsidiaries’ transmission systems to investor-owned utilities such as Detroit Edison, Consumers Energy and IP&L, and to other entities such as alternative electricity suppliers, power marketers and other wholesale customers that provide electricity to end-use consumers and from transaction-based capacity reservations on our transmission systems.

Significant recent matters that influenced our financial position and results of operations and cash flows for the nine months ended September 30, 2013 or may affect future results include:

Our capital investment of \$648.9 million at our Regulated Operating Subsidiaries for the nine months ended September 30, 2013, resulting primarily from our focus on improving system reliability, increasing system capacity and upgrading the transmission network to support new generating resources;

Debt issuances as described in Note 5 to the condensed consolidated financial statements and borrowings under our revolving and term loan credit agreements in 2013 and 2012 to fund capital investment at our Regulated Operating Subsidiaries, resulting in higher interest expense;

Debt maturing within one year of \$210.0 million as of September 30, 2013 and the interest rates associated with the additional financing required; and

The proposed transaction with Entergy in which Entergy will divest and merge its electric transmission business with a wholly-owned subsidiary of ITC Holdings (“Entergy Transaction”) as discussed below under “Capital Project Updates and Other Recent Developments.” For the three and nine months ended September 30, 2013, we expensed external legal, advisory and financial services fees of \$7.2 million and \$34.9 million, respectively, and certain internal labor costs of \$1.9 million and \$7.1 million, respectively, related to the Entergy Transaction. Certain amounts of the external costs are not expected to be deductible for income tax purposes. The external and internal costs related to the Entergy Transaction are not included as components of revenue requirement as they were incurred at ITC Holdings. The transaction fees are expected to continue to be significant until the transaction is consummated.

These items are discussed in more detail throughout Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Capital Project Updates and Other Recent Developments

Thumb Loop Project

The Thumb Loop Project is located in ITCTransmission’s region and consists of a 140-mile, double-circuit 345 kV transmission line and related substations that will serve as the backbone of the transmission system needed to accommodate future wind development projects in the Michigan counties of Tuscola, Huron, Sanilac and St. Clair. Construction activities commenced for the Thumb Loop Project in 2012. In September 2013, Phase 1 of the Thumb Loop project, consisting of 62 miles of 345 kV transmission facilities, was placed into service. Through September 30, 2013, ITCTransmission has invested \$287.4 million in the Thumb Loop Project. We estimate ITCTransmission will invest a total of approximately \$510 million to complete construction of the project.

## Table of Contents

### ITC Great Plains

#### Kansas V-Plan Project

The Kansas V-Plan Project is a 200-mile long transmission line that will run between Spearville and Wichita, Kansas. ITC Great Plains is responsible for constructing an approximately 120-mile portion of the project from Spearville to Medicine Lodge, Kansas. ITC Great Plains commenced construction during 2012, and through September 30, 2013, ITC Great Plains has invested \$139.3 million in the Kansas V-Plan Project. We estimate that ITC Great Plains will invest a total of approximately \$300 million to complete construction of its portion of the project.

#### Regulatory Assets

As of September 30, 2013, we have recorded a total of \$13.9 million of regulatory assets for start-up, development and pre-construction expenses, including associated carrying charges, incurred by ITC Great Plains, which include certain costs incurred for the Kansas Electric Transmission Authority (“KETA”) Project and the Kansas V-Plan Project prior to construction. Based on ITC Great Plains’ FERC application under which authority to recognize these regulatory assets was sought and the related FERC order granting such authority, ITC Great Plains made a filing with the FERC under Section 205 of the FPA in May 2013 to recover these start-up, development and pre-construction expenses, including associated carrying charges, in future rates.

#### Development Bonuses

We recognized general and administrative expenses of \$0.9 million and \$3.0 million during the three and nine months ended September 30, 2013, respectively, and \$1.4 million and \$2.0 million during the three and nine months ended September 30, 2012, respectively, for bonuses for the successful completion of certain milestones relating to projects at ITC Great Plains. It is reasonably possible that future development-related bonuses may be authorized and awarded for these or other development projects.

#### North Central Region Development

In 2009, we announced the Green Power Express project, which consisted of transmission line segments that would facilitate the movement of power from the Dakotas, Minnesota and Iowa to Midwest load centers that demand energy. After the announcement of the Green Power Express project, MISO undertook its Regional Generation Outlet Study (“RGOS”) to promote investments in new regional transmission infrastructure and implemented its Multi-Value Project (“MVP”) cost allocation methodology. MISO’s RGOS and MVP processes provide a channel for the Green Power Express project, or its underlying segments, to move forward through the planning approval process as MVPs. In December 2011, MISO approved the first portfolio of MVPs identified through the RGOS which includes portions of four MVPs that we intend to build, own and operate. The four MVPs are located in south central Minnesota, northern and southeast Iowa, southwest Wisconsin, and northeast Missouri.

We continue to explore other opportunities to advance segments of our Green Power Express project, or similar RGOS projects, through the MISO MVP process.

#### Entergy Transaction

As of December 4, 2011, Entergy and ITC Holdings executed definitive agreements (as subsequently amended, the “transaction agreements”) under which Entergy will divest and then merge its electric transmission business with a wholly-owned subsidiary of ITC Holdings. Entergy’s electric transmission business consists of approximately 15,400 miles of interconnected transmission lines at voltages of 69 kV and above and associated substations across its utility service territory in the mid-south.

The Entergy Transaction would expand our network across the entire middle of the continental United States from the Great Lakes to the Gulf Coast. It would approximately double our asset base, add sizable new markets to our operating and development portfolio, and diversify and enhance growth prospects through an expanded footprint.

The terms of the transaction agreements call for Entergy to divest its electric transmission business to a newly-formed entity, Mid South TransCo LLC (“Mid South TransCo”), and Mid South TransCo’s subsidiaries, and distribute the equity interests in Mid South TransCo to Entergy’s shareholders in the form of a tax-free spin-off or split-off exchange offer or a combination of both. Mid South TransCo will then merge with a newly-created merger subsidiary of ITC Holdings in an all-stock, Reverse Morris Trust transaction, and will survive the merger as a wholly owned subsidiary of ITC Holdings. Prior to



## Table of Contents

the merger, we expect to effectuate a recapitalization which will not exceed \$700 million and which may take the form of a one-time special dividend to ITC Holdings' pre-merger shareholders, a repurchase of ITC Holdings common stock from its shareholders, or a combination of a special dividend and share repurchase. The merger would result in shareholders of Entergy receiving approximately 50.1% of the shares of ITC Holdings outstanding immediately following the merger in exchange for their shares of Mid South TransCo, with the shareholders of ITC Holdings immediately prior to the merger owning the remaining approximately 49.9% equity interest in the combined company immediately after the merger. In addition, Entergy would receive gross cash proceeds of \$1.775 billion from indebtedness that would be incurred by Mid South TransCo and its subsidiaries prior to the merger. This indebtedness would be assumed by us upon completion of the transaction.

On April 16, 2013 and June 20, 2013, ITC Holdings received shareholder approval and FERC approval, respectively, necessary to consummate the merger. In addition, Entergy has received a favorable ruling on the tax free nature of the transaction from the Internal Revenue Service. Completion of the Entergy Transaction is not expected prior to 2014 and remains subject to the satisfaction of certain closing conditions, including receipt of the necessary approvals of Entergy's retail regulators. There can be no assurance the Entergy Transaction will be consummated. See "Item 1A Risk Factors — We may be unable to satisfy the conditions or obtain the approvals required to complete the Entergy Transaction or such approvals may contain material restrictions or conditions" of our Form 10-K for the fiscal year ended December 31, 2012.

Under the terms of the transaction agreements, prior to completion of the Entergy Transaction, there are certain restrictions on our ability to pay dividends other than those paid in the ordinary course of business with record dates and payment dates consistent with our past practice and, if elected, a one-time special dividend to ITC Holdings' pre-merger shareholders in accordance with the transaction agreements. Management does not expect the restrictions to have an impact on our ability to pay dividends at the current level in the foreseeable future.

### Cost-Based Formula Rates with True-Up Mechanism

Our Regulated Operating Subsidiaries calculate their revenue requirements using cost-based formula rate templates and are effective without the need to file rate cases with the FERC, although the rates are subject to legal challenge at the FERC. Under these formula rate templates, our Regulated Operating Subsidiaries recover expenses and earn a return on and recover investments in property, plant and equipment on a current rather than a lagging basis. The formula rate templates utilize forecasted expenses, property, plant and equipment, point-to-point revenues, network load at our MISO Regulated Operating Subsidiaries and other items for the upcoming calendar year to establish projected revenue requirements for each of our Regulated Operating Subsidiaries that are used as the basis for billing for service on their systems from January 1 to December 31 of that year. Our cost-based formula rate templates include a true-up mechanism, whereby our Regulated Operating Subsidiaries compare their actual revenue requirements to their billed revenues for each year to determine any over- or under-collection of revenue. The over- or under-collection typically results from differences between the projected revenue requirement used as the basis for billing and actual revenue requirement at each of our Regulated Operating Subsidiaries, or from differences between actual and projected monthly peak loads at our MISO Regulated Operating Subsidiaries. In the event billed revenues in a given year are more or less than actual revenue requirements, which are calculated primarily using information from that year's FERC Form No. 1, our Regulated Operating Subsidiaries will refund or collect additional revenues, with interest, within a two-year period such that customers pay only the amounts that correspond to actual revenue requirements for that given period. This annual true-up ensures that our Regulated Operating Subsidiaries recover their allowed costs and earn their allowed returns.

### Revenue Accruals and Deferrals — Effects of Monthly Peak Loads

For our MISO Regulated Operating Subsidiaries, monthly peak loads are used for billing network revenues, which currently is the largest component of our operating revenues. One of the primary factors that impacts the revenue accruals and deferrals at our MISO Regulated Operating Subsidiaries is actual monthly peak loads experienced as compared to those forecasted in establishing the annual network transmission rate. Under their cost-based formula rates that contain a true-up mechanism, our Regulated Operating Subsidiaries accrue or defer revenues to the extent that their actual revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. For example, to the extent that amounts billed are less than the revenue requirement



for a reporting period, a revenue accrual is recorded for the difference. To the extent that amounts billed are more than the revenue requirement for a reporting period, a revenue deferral is recorded for the difference. Although monthly peak loads do not impact operating revenues recognized, network load affects the timing of our cash flows from transmission service. The monthly peak load of our MISO Regulated Operating Subsidiaries is affected by many variables, but is generally impacted by weather and economic conditions and is seasonally shaped with higher load in the summer months when cooling demand is higher.

Table of Contents

The following table sets forth the monthly peak loads during the last three calendar years.

Monthly Peak Load (in MW) (a)

	2013			2012			2011		
	ITC Transmission	METC	ITC Midwest	ITC Transmission	METC	ITC Midwest	ITC Transmission	METC	ITC Midwest
January	7,593	6,215	2,801	7,264	6,145	2,789	7,326	6,045	2,777
February	7,141	5,846	2,677	6,919	5,754	2,592	7,261	6,058	2,854
March	6,817	5,552	2,542	6,941	5,708	2,443	6,946	5,715	2,520
April	6,566	5,321	2,463	6,403	5,259	2,296	6,483	5,416	2,458
May	8,956	6,490	2,563	8,947	6,459	2,700	10,119	7,239	2,773
June	10,335	7,647	3,194	11,652	8,738	3,388	11,488	8,231	3,403
July	11,694	8,986	3,563	12,180	9,354	3,636	12,321	9,389	3,621
August	10,158	7,810	3,521	11,081	8,508	3,445	11,158	8,538	3,614
September	11,047	8,169	3,430	9,094	7,349	3,443	11,288	7,966	3,466
October				6,566	5,429	2,539	6,642	5,479	2,559
November				7,022	5,829	2,631	7,101	6,061	2,556
December				7,230	5,928	2,645	7,206	6,071	2,734
Total	80,307	62,036	26,754	101,299	80,460	34,547	105,339	82,208	35,335

(a) Our MISO Regulated Operating Subsidiaries are each part of a joint rate zone. The load data presented is for all transmission owners in the respective joint rate zone and is used for billing network revenues. Each of our MISO Regulated Operating Subsidiaries makes up the most significant portion of the rates or revenue requirement billed to network load within their respective joint rate zone.

#### Capital Investment and Operating Results Trends

We expect a general trend of increases in revenues and earnings for our Regulated Operating Subsidiaries over the long term. The primary factor that is expected to continue to increase our actual revenue requirements in future years is our anticipated capital investment in excess of depreciation as a result of our Regulated Operating Subsidiaries' long-term capital investment programs to improve reliability, increase system capacity and upgrade the transmission network to support new generating resources. In addition, our capital investment efforts relating to development initiatives are based on establishing an ongoing pipeline of projects that will position us for long-term growth.

Investments in property, plant and equipment, when placed in service upon completion of a capital project, are added to the rate base of our Regulated Operating Subsidiaries.

Our Regulated Operating Subsidiaries strive for high reliability of their systems and to improve system accessibility for all generation resources. The FERC requires adoption of certain reliability standards and may take enforcement actions against violators, including fines of up to \$1.0 million per day. The NERC was assigned the responsibility of developing and enforcing these mandatory reliability standards. We continually assess our transmission systems against standards established by the NERC, as well as the standards of applicable regional entities under the NERC that have been delegated certain authority for the purpose of proposing and enforcing reliability standards. We believe we meet the applicable standards in all material respects, although further investment in our transmission systems and an increase in maintenance activities will likely be needed to maintain compliance, improve reliability and address any new standards that may be promulgated.

Table of Contents

We also assess our transmission systems against our own planning criteria that are filed annually with the FERC. Based on our planning studies, we see needs to make capital investments to (1) rebuild existing property, plant and equipment; (2) upgrade the system to address demographic changes that have impacted transmission load and the changing role that transmission plays in meeting the needs of the wholesale market, including accommodating the siting of new generation or to increase import capacity to meet changes in peak electrical demand; (3) relieve congestion in the transmission systems; and (4) achieve state and federal policy goals, such as renewable generation portfolio standards. The following table shows our expected and actual capital investment for each of the Regulated Operating Subsidiaries and our development initiatives:

(in millions)	Long-term Capital Investment Program	Actual Capital Investment for the nine months ended September 30, 2013	Forecasted Capital Investment for the year ending December 31, 2013
Source of Investment	2012-2016 (a)	(b)	(a)
ITC Transmission (c)	\$739	\$170.7	\$215 — 230
METC	581	127.8	170 — 180
ITC Midwest	1,128	245.8	285 — 300
ITC Great Plains (d)	343	104.6	140 — 150
Development (e)	1,390	—	—
Total	\$4,181	\$648.9	\$810 — 860

The current long-term capital investment program does not include anticipated expenditures related to the Entergy Transaction or in the subsidiaries of Mid South TransCo post-closing. The forecasted investments in property, plant and equipment would be expected to increase significantly following closing of that transaction. The forecasted (a) investments in property, plant and equipment do not reflect any potential modifications resulting from the recently issued FERC order indicating that the use of Attachment FF for ITC Midwest was no longer just and reasonable as discussed in Note 3 to the condensed consolidated financial statements under “Complaint of IP&L.” We do not anticipate a material impact on our long-term capital investment plan as a result of this order.

Capital investment amounts differ from cash expenditures for property, plant and equipment included in our condensed consolidated statements of cash flows due in part to differences in construction costs incurred compared (b) to cash paid during that period, as well as payments for major equipment inventory that are included in cash expenditures but not included in capital investment until transferred to construction work in progress, among other factors.

(c) ITC Transmission’s investment program includes the Thumb Loop Project that is under construction.

(d) ITC Great Plains’ investment program includes the Kansas V-Plan Project that is under construction.

The long-term capital investment program includes expenditures to construct various development projects, including our portions of the four MISO MVPs as discussed under “Capital Project Updates and Other Recent (e) Developments — North Central Region Development.” However, actual capital investments associated with our portions of the MISO MVPs are included in ITC Midwest’s actual capital investment through September 30, 2013 as ITC Midwest will construct, own and operate such projects.

Investments in property, plant and equipment could vary due to, among other things, the impact of actual loads, forecasted loads, regional economic conditions, weather conditions, union strikes, labor shortages, material and equipment prices and availability, our ability to obtain any necessary financing for such expenditures, limitations on the amount of construction that can be undertaken on our systems at any one time, regulatory approvals for reasons relating to rate construct, environmental, siting, regional planning, cost recovery or other issues or as a result of legal proceedings, including the Attachment FF policy changes for ITC Midwest described in Note 3 to the condensed consolidated financial statements under Complaint of IP&L, and variances between estimated and actual costs of construction contracts awarded. In addition, investments in transmission network upgrades for generator interconnection projects could change from prior estimates significantly due to changes in the MISO queue for

generation projects, the generator's potential failure to meet the various criteria of Attachment FF of the MISO tariff for the project to qualify as a refundable network upgrade, and other factors beyond our control.

Table of Contents

## RESULTS OF OPERATIONS

## Results of Operations and Variances

(in thousands)	Three months ended		Increase (decrease)	Percentage increase (decrease)		Nine months ended		Increase (decrease)	Percentage increase (decrease)	
	September 30, 2013	2012				September 30, 2013	2012			
OPERATING REVENUES	\$238,782	\$214,801	\$23,981	11.2	%	\$685,903	\$608,889	\$77,014	12.6	%
OPERATING EXPENSES										
Operation and maintenance	29,725	31,544	(1,819 )	(5.8 )	%	83,906	90,314	(6,408 )	(7.1 )	%
General and administrative	31,902	27,906	3,996	14.3	%	110,767	78,791	31,976	40.6	%
Depreciation and amortization	29,802	27,466	2,336	8.5	%	87,583	78,453	9,130	11.6	%
Taxes other than income taxes	16,728	14,721	2,007	13.6	%	49,492	44,186	5,306	12.0	%
Other operating (income) and expenses — net	(197 )	(190 )	(7 )	3.7	%	(542 )	(586 )	44	(7.5 )	%
Total operating expenses	107,960	101,447	6,513	6.4	%	331,206	291,158	40,048	13.8	%
OPERATING INCOME	130,822	113,354	17,468	15.4	%	354,697	317,731	36,966	11.6	%
OTHER EXPENSES (INCOME)										
Interest expense	44,062	38,924	5,138	13.2	%	123,527	116,918	6,609	5.7	%
Allowance for equity funds used during construction	(8,290 )	(5,622 )	(2,668 )	47.5	%	(25,315 )	(15,800 )	(9,515 )	60.2	%
Other income	(786 )	(884 )	98	(11.1 )	%	(824 )	(2,171 )	1,347	(62.0 )	%
Other expense	2,164	1,415	749	52.9	%	5,388	2,473	2,915	117.9	%
Total other expenses (income)	37,150	33,833	3,317	9.8	%	102,776	101,420	1,356	1.3	%
INCOME BEFORE INCOME TAXES	93,672	79,521	14,151	17.8	%	251,921	216,311	35,610	16.5	%
INCOME TAX PROVISION	34,688	28,338	6,350	22.4	%	95,352	76,691	18,661	24.3	%
NET INCOME	\$58,984	\$51,183	\$7,801	15.2	%	\$156,569	\$139,620	\$16,949	12.1	%

## Operating Revenues

Three months ended September 30, 2013 compared to three months ended September 30, 2012

The following table sets forth the components of and changes in operating revenues:

(in thousands)	2013		Percentage	2012		Increase (decrease)	Percentage increase (decrease)		
	Amount	Percentage		Amount	Percentage				
Network revenues	\$185,165	77.5	%	\$171,703	79.9	%	\$13,462	7.8	%
Regional cost sharing revenues	44,676	18.7	%	33,189	15.5	%	11,487	34.6	%
Point-to-point	4,684	2.0	%	4,859	2.3	%	(175 )	(3.6 )	%
Scheduling, control and dispatch	2,962	1.2	%	4,408	2.1	%	(1,446 )	(32.8 )	%

Edgar Filing: ITC Holdings Corp. - Form 10-Q

Other	1,295	0.6	%	642	0.2	%	653	101.7	%
Total	\$238,782	100.0	%	\$214,801	100.0	%	\$23,981	11.2	%

Network revenues increased due primarily to higher net revenue requirements at our Regulated Operating Subsidiaries during the three months ended September 30, 2013 as compared to the same period in 2012. Higher net revenue requirements were due primarily to higher rate bases associated with higher balances of property, plant and equipment in-service.

Regional cost sharing revenues increased due primarily to additional capital projects that have been identified by MISO as eligible for regional cost sharing and these projects being placed in-service. We expect to continue to receive regional cost sharing revenues and the amounts could increase in the near future, including revenues associated with projects that have been or are expected to be approved for regional cost sharing.

Scheduling, control and dispatch revenues decreased due primarily to adjustments made in 2013 to the MISO Regulated Operating Subsidiaries scheduling, control and dispatch revenues as a result of a true-up mechanism, implemented beginning in 2013, which ensures that our MISO Regulated Operating Subsidiaries recover their allowed costs.

Table of Contents

Nine months ended September 30, 2013 compared to nine months ended September 30, 2012

The following table sets forth the components of and changes in operating revenues:

(in thousands)	2013		2012		Increase (decrease)	Percentage increase (decrease)
	Amount	Percentage	Amount	Percentage		
Network revenues	\$534,330	77.9 %	\$491,312	80.7 %	\$43,018	8.8 %
Regional cost sharing revenues	122,470	17.9 %	87,905	14.4 %	34,565	39.3 %
Point-to-point	13,108	1.9 %	13,446	2.2 %	(338)	(2.5)%
Scheduling, control and dispatch	9,084	1.3 %	11,487	1.9 %	(2,403)	(20.9)%
Other	6,911	1.0 %	4,739	0.8 %	2,172	45.8 %
Total	\$685,903	100.0 %	\$608,889	100.0 %	\$77,014	12.6 %

Network revenues increased due primarily to higher net revenue requirements at our Regulated Operating Subsidiaries during the nine months ended September 30, 2013 as compared to the same period in 2012. Higher net revenue requirements were due primarily to higher rate bases associated with higher balances of property, plant and equipment in-service and the initial recognition of the FERC audit refund in the second quarter of 2012 as described in Note 11 to the condensed consolidated financial statements.

Regional cost sharing revenues increased due primarily to additional capital projects that have been identified by MISO as eligible for regional cost sharing and these projects being placed in-service.

Scheduling, control and dispatch revenues decreased due primarily to the true-up adjustment included in 2013.

Operating revenues for the nine months ended September 30, 2013 include the network, regional cost sharing and scheduling, control and dispatch revenue deferrals as calculated below:

Line	Item	ITC	ITC	Total	
		Transmission	Great	net	
		METC	Plains	revenue	
		Midwest		deferral	
	(in thousands)				
1	Estimated net revenue requirement (network revenues recognized) (a)	\$ 179,106	\$ 151,887	\$ 199,049	\$ 4,288
2	Network revenues billed (b)	191,131	164,582	215,720	4,298
3	Network revenue deferrals (line 1 — line 2)	(12,025)	(12,695)	(16,671)	(10)
4	Regional cost sharing revenue deferrals (c)	(9,304)	(6,509)	(1,457)	(1,998)
5	Scheduling, control and dispatch revenue deferrals (d)	(997)	(1,024)	(938)	—
6	Total net revenue deferrals (line 3 + line 4 + line 5)	\$ (22,326)	\$ (20,228)	\$ (19,066)	\$ (2,008)
					\$ (63,628)

The calculation of net revenue requirement for our Regulated Operating Subsidiaries is described in our Form 10-K for the year ended December 31, 2012 under "Item 7 Management's Discussion and Analysis of Financial Condition (a) and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism — Revenue Requirement Calculation." The amount is estimated for each reporting period until such time as FERC Form No. 1's are completed for our Regulated Operating Subsidiaries.

(b) Network revenues billed at our MISO Regulated Operating Subsidiaries are calculated based on the joint zone monthly network peak load multiplied by their effective monthly network rates for 2013 of \$2.147 per kW/month, \$2.5263 per kW/month and \$7.805 per kW/month applicable to ITC Transmission, METC and ITC Midwest, respectively, adjusted for the actual number of days in the month less amounts recovered or refunded associated with our MISO Regulated Operating Subsidiaries 2011 true-up adjustments. The rates for 2013 include amounts for the collection and refund of the 2011 revenue accruals and deferrals and related accrued interest, but the revenues billed in 2013 associated with the 2011 revenue accruals and deferrals are not included in these amounts. On August 29, 2013, ITC Transmission's projected network rate of \$2.305 per kW/month, METC's projected

network rate of \$2.781 per kW/month and ITC Midwest's projected network rate of \$8.805 per kW/month, in each case for the period from January 1, 2014 through December 31, 2014, were posted by MISO. Our rates at ITC Great Plains are billed ratably each month based on its annual projected net revenue requirement and include amounts for the collection and refund of the 2011 revenue accruals and deferrals and related accrued interest. ITC Great Plains' projected revenue requirement of \$56.8 million for the period from January 1, 2014 through December 31, 2014 was posted by SPP on August 29, 2013.



Table of Contents

Regional cost sharing revenues are subject to a separate true-up mechanism whereby our Regulated Operating Subsidiaries accrue or defer revenues for any over- or under-recovery. The revenue accruals and deferrals and related accrued interest associated with regional cost sharing revenues are included in the regional cost sharing revenue amounts.

(c) Beginning in 2013, a significant portion of our MISO Regulated Operating Subsidiaries' scheduling, control and dispatch revenues are subject to a separate true-up mechanism whereby our MISO Regulated Operating Subsidiaries accrue or defer revenues for any over- or under-recovery. The revenue accruals and deferrals and related accrued interest associated with the MISO Regulated Operating Subsidiaries' scheduling, control and dispatch revenues are included in the scheduling, control and dispatch revenue amounts.

Operating Expenses

Operation and maintenance expenses

Three months ended September 30, 2013 compared to three months ended September 30, 2012

Operation and maintenance expenses decreased primarily due to lower vegetation management requirements of \$1.2 million and lower NERC compliance activities associated with surveying transmission overhead lines of \$0.9 million. Nine months ended September 30, 2013 compared to nine months ended September 30, 2012

Operation and maintenance expenses decreased primarily due to lower vegetation management requirements of \$3.9 million and lower NERC compliance activities associated with surveying transmission overhead lines of \$2.5 million.

General and administrative expenses

Three months ended September 30, 2013 compared to three months ended September 30, 2012

General and administrative expenses increased due to increased general business expenses of \$1.9 million primarily due to an increase in information technology expenses, \$1.6 million due to higher external legal, advisory and financial services fees for the Entergy Transaction, and higher compensation-related expenses of \$1.4 million primarily due to personnel increases. These increases were partially offset by a decrease of \$0.8 million in other professional services primarily due to lower outside legal fees not associated with the Entergy Transaction. Nine months ended September 30, 2013 compared to nine months ended September 30, 2012

General and administrative expenses increased due to higher external legal, advisory and financial services fees for the Entergy Transaction of \$22.8 million, higher compensation-related expenses of \$5.1 million primarily due to personnel increases and an increase in other professional services, such as legal, advisory and financial services fees, of \$1.9 million.

Depreciation and amortization expenses

Three and nine months ended September 30, 2013 compared to three and nine months ended September 30, 2012

Depreciation and amortization expenses increased due primarily to a higher depreciable base resulting from property, plant and equipment additions.

Taxes other than income taxes

Three and nine months ended September 30, 2013 compared to three and nine months ended September 30, 2012

Taxes other than income taxes increased due to higher property tax expenses due primarily to our Regulated Operating Subsidiaries' 2012 capital additions, which are included in the assessments for 2013 personal property taxes.

Table of Contents

Other Expenses (Income)

Three and nine months ended September 30, 2013 compared to three and nine months ended September 30, 2012

Interest Expense

Interest expense increased primarily due to interest associated with the long-term debt issuances at ITC Holdings and the Regulated Operating Subsidiaries which was used for refinancing of current debt maturities and general corporate purposes as described in Note 5 to the condensed consolidated financial statements.

Allowance for Equity Funds Used During Construction

Allowance for Equity Funds Used During Construction (“AFUDC equity”) increased due primarily to higher balances of construction work in progress during the period.

Income Tax Provision

Three months ended September 30, 2013 compared to three months ended September 30, 2012

Our effective tax rates for the three months ended September 30, 2013 and 2012 were 37.0% and 35.6%, respectively. Our effective tax rate in both years exceeded our 35% statutory federal income tax rate due primarily to state income taxes as well as the non-deductibility of certain costs incurred to facilitate the consummation of the Entergy Transaction, offset by the tax effects of AFUDC equity which reduced the effective tax rate. The amount of income tax expense relating to AFUDC equity was recognized as a regulatory asset and not included in the income tax provision. We recorded a state income tax provision of \$3.4 million (net of federal deductibility) during the three months ended September 30, 2013, compared to a state income tax provision of \$1.8 million (net of federal deductibility) for the three months ended September 30, 2012.

Nine months ended September 30, 2013 compared to nine months ended September 30, 2012

Our effective tax rates for the nine months ended September 30, 2013 and 2012 were 37.8% and 35.5%, respectively. Our effective tax rate in both years exceeded our 35% statutory federal income tax rate due primarily to state income taxes as well as the non-deductibility of certain costs incurred to facilitate the consummation of the Entergy Transaction, offset by the tax effects of AFUDC equity which reduced the effective tax rate. The amount of income tax expense relating to AFUDC equity was recognized as a regulatory asset and not included in the income tax provision. We recorded a state income tax provision of \$8.8 million (net of federal deductibility) during the nine months ended September 30, 2013, compared to a state income tax provision of \$4.2 million (net of federal deductibility) for the nine months ended September 30, 2012.

LIQUIDITY AND CAPITAL RESOURCES

We expect to fund our future capital requirements with cash from operations, our existing cash and cash equivalents and amounts available under our revolving credit agreements (described in Note 5 to the condensed consolidated financial statements). In addition, we may from time to time secure debt and equity funding in the capital markets, although we can provide no assurance that we will be able to obtain financing on favorable terms or at all. We expect that our capital requirements will arise principally from our need to:

Fund capital expenditures at our Regulated Operating Subsidiaries and, following the close of the Entergy Transaction, capital expenditures at the subsidiaries of Mid South TransCo. Our plans with regard to property, plant and equipment investments are described in detail above under “— Capital Investment and Operating Results Trends.”

Fund business development expenses and related capital expenditures. We are pursuing development activities for transmission projects which will continue to result in the incurrence of development expenses and could result in significant capital expenditures.

Fund working capital requirements.

Fund our debt service requirements. We expect our interest payments to increase each year as a result of additional debt we expect to incur to fund our capital expenditures.

Fund dividends or any recapitalization associated with the Entergy transaction to holders of our common stock.

Table of Contents

Fund contributions to our retirement plans, as described in Note 9 to the condensed consolidated financial statements. We expect to contribute up to \$1.5 million to these plans during the remainder of 2013. The impact of the growth in the number of participants in our retirement benefit plans and changes in the requirements of the Pension Protection Act may require contributions to our retirement plans to be higher than we have experienced in the past.

In addition to the expected capital requirements above, any adverse determinations relating to the contingencies described in Note 11 to the condensed consolidated financial statements would result in additional capital requirements.

We believe that we have sufficient capital resources to meet our currently anticipated short-term needs. We rely on both internal and external sources of liquidity to provide working capital and to fund capital investments. We expect to continue to utilize our revolving and term loan credit agreements and our cash and cash equivalents as needed to meet our short-term cash requirements. As of September 30, 2013, we had consolidated indebtedness under our revolving and term loan credit agreements of \$474.1 million, with unused capacity under the agreements of \$510.9 million. See Note 5 to the condensed consolidated financial statements for a detailed discussion of these agreements and borrowing and repayment activity during the nine months ended September 30, 2013. During the three months ended September 30, 2013, we completed the financings as described below.

On July 3, 2013, ITC Holdings issued \$250.0 million aggregate principal amount of its 4.05% Senior Notes, due July 1, 2023 and \$300.0 million aggregate principal amount of its 5.30% Senior Notes, due July 1, 2043. The proceeds from these issuances were used to repay its \$267.0 million of 5.25% Senior Notes due July 15, 2013, the \$200.0 million borrowed under an unsecured, unguaranteed term loan credit agreement entered into in 2012, a portion of the amount borrowed under the 2013 Term Loan and for general corporate purposes.

On July 11, 2013, ITCTransmission entered into a new unsecured, unguaranteed term loan credit agreement, due July 14, 2014, under which ITCTransmission borrowed the maximum of \$185.0 million upon entering the agreement to repay its \$185.0 million of 4.45% First Mortgage Bonds, Series A, due July 15, 2013. This borrowing was repaid in full as of September 30, 2013.

On August 14, 2013, ITCTransmission issued \$285.0 million aggregate principal amount of 4.625% First Mortgage Bonds, Series E, due August 15, 2043. The proceeds from the issuance were used to repay its term loan credit agreement of \$185.0 million and \$100.0 million outstanding under an intercompany advance agreement between ITCTransmission and ITC Holdings. ITCTransmission's First Mortgage Bonds are issued under its First Mortgage and Deed of Trust and are secured by a first mortgage lien on substantially all of ITCTransmission's property.

As of September 30, 2013, we had approximately \$210.0 million of debt maturing within one year, which is expected to be refinanced with long-term debt. In addition, for our long-term capital requirements and the funding of the anticipated \$700 million recapitalization in connection with the Entergy Transaction, we expect that we will need to obtain additional debt financing. Certain of our capital projects could be delayed in the event we experience difficulties in accessing capital. We expect to be able to obtain such additional financing for both our short and long-term requirements as needed, in amounts and upon terms that will be reasonably satisfactory to us due to our strong credit ratings and our historical ability to obtain financing.

**Credit Ratings**

Credit ratings by nationally recognized statistical rating agencies are an important component of our liquidity profile. Credit ratings relate to our ability to issue debt securities and the cost to borrow money, and should not be viewed as an indication of future stock performance or a recommendation to buy, sell, or hold securities. Ratings are subject to revision or withdrawal at any time and each rating should be evaluated independently of any other rating. Our current credit ratings are displayed in the following table. An explanation of these ratings may be obtained from the respective rating agency.

Table of Contents

	Issuer	Issuance	Standard and Poor's Ratings Services (a)	Moody's Investor Service, Inc. (b)
ITC Holdings	Senior Unsecured Notes		BBB	Baa2
ITCTransmission	First Mortgage Bonds		A	A1
METC	Senior Secured Notes		A	A1
ITC Midwest	First Mortgage Bonds		A	A1
ITC Great Plains	Unsecured Credit Facility		BBB+	Baa1

(a) On June 28, 2013, Standard and Poor's Financial Services completed their semi-annual review and made no changes to the existing ratings. All of the ratings have a stable outlook.

(b) Moody's Investor Service, Inc. updated their credit opinions on April 15, 2013 and made no changes to the credit ratings. All of the ratings have a stable outlook.

**Covenants**

Our debt instruments include senior notes, secured notes, first mortgage bonds, unsecured term loans and revolving credit agreements containing numerous financial and operating covenants that place significant restrictions, which are described in Note 5 to the condensed consolidated financial statements and in our Form 10-K for the fiscal year ended December 31, 2012. As of September 30, 2013, we were in compliance with all debt covenants and in the event of a downgrade in our credit ratings, none of the covenants would be directly impacted, although the borrowing costs under our revolving credit agreements would increase.

**Cash Flows From Operating Activities**

Net cash provided by operating activities was \$292.2 million and \$258.4 million for the nine months ended September 30, 2013 and 2012, respectively. The increase in cash provided by operating activities was due primarily to an increase in cash received from operating revenues of \$48.9 million and the timing of tax payments, which resulted in lower income taxes paid of \$14.4 million during the nine months ended September 30, 2013 compared to the same period in 2012. These increases were partially offset by additional interest payments (net of interest capitalized) of \$23.0 million.

**Cash Flows From Investing Activities**

Net cash used in investing activities was \$635.0 million and \$643.0 million for the nine months ended September 30, 2013 and 2012, respectively. The decrease in cash used in investing activities was due primarily to the timing of payments for investments in property, plant and equipment and lower net cash flows associated with the sales and purchases of securities related to our supplemental nonqualified retirement benefit plans during the nine months ended September 30, 2013 compared to the same period in 2012.

**Cash Flows From Financing Activities**

Net cash provided by financing activities was \$367.4 million and \$356.3 million for the nine months ended September 30, 2013 and 2012, respectively. The increase in cash provided by financing activities was due primarily to the proceeds of \$933.0 million received from the issuance of long-term debt in 2013 as compared to the proceeds of \$100.0 million received from the issuance of long-term debt in 2012. This increase was partially offset by the payments of \$452.0 million to retire long-term debt at ITC Holdings and ITCTransmission and the net decrease of \$366.9 million in amounts outstanding under our revolving and term loan credit agreements during the nine months ended September 30, 2013 compared to the same period in 2012. See Note 5 to the condensed consolidated financial statements for detail on the issuances and retirements of long-term debt.

**CONTRACTUAL OBLIGATIONS**

Our contractual obligations are described in our Form 10-K for the year ended December 31, 2012. There have been no material changes to that information since December 31, 2012, other than the items listed below and described in Note 5 to the condensed consolidated financial statements:

• Amounts borrowed under our revolving credit agreements;

• The issuance of \$100.0 million of 4.09% First Mortgage Bonds, Series F, due January 2043 by ITC Midwest;



Table of Contents

The \$160.0 million currently borrowed under the ITC Holdings unsecured, unguaranteed term loan credit agreement entered into in February 2013, due December 2013, which repaid outstanding revolving credit borrowings and was used for general corporate purposes;

The \$100.0 million borrowed under the ITC Great Plains unsecured, unguaranteed term loan credit agreement entered into in May 2013, due November 2014, which repaid outstanding revolving credit borrowings;

The issuance of \$250.0 million aggregate principal amount of ITC Holdings 4.05% Senior Notes, due 2023 and \$300.0 million aggregate principal amount of ITC Holdings 5.30% Senior Notes, due 2043, in July 2013, which together repaid \$200.0 million outstanding under an unsecured, unguaranteed term loan credit agreement entered into in 2012 by ITC Holdings and \$267.0 million outstanding under its 5.25% Senior Notes due July 2013; and

The issuance of \$285.0 million aggregate principal amount of ITC Transmission 4.625% First Mortgage Bonds due August 2043, which repaid \$185.0 million outstanding under the unsecured, unguaranteed ITC Transmission term loan credit agreement entered into in July 2013 and \$100.0 million outstanding under an intercompany advance agreement between ITC Transmission and ITC Holdings.

**CRITICAL ACCOUNTING POLICIES**

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of these condensed consolidated financial statements requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. The application of these policies necessarily involves judgments regarding future events. These estimates and judgments, in and of themselves, could materially impact the condensed consolidated financial statements and disclosures based on varying assumptions, as future events rarely develop exactly as forecasted, and even the best estimates routinely require adjustment. The accounting policies discussed in “Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies” in our Form 10-K for the fiscal year ended December 31, 2012 are considered by management to be the most important to an understanding of the consolidated financial statements because of their significance to the portrayal of our financial condition and results of operations or because their application places the most significant demands on management’s judgment and estimates about the effect of matters that are inherently uncertain. There have been no material changes to that information during the nine months ended September 30, 2013.

**RECENT ACCOUNTING PRONOUNCEMENTS**

See Note 2 to the condensed consolidated financial statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Fixed Rate Debt**

Based on the borrowing rates currently available for bank loans with similar terms and average maturities, the fair value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,377.0 million at September 30, 2013. The total book value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,100.8 million at September 30, 2013. We performed an analysis calculating the impact of changes in interest rates on the fair value of long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, at September 30, 2013. An increase in interest rates of 10% (from 5.0% to 5.5%, for example) at September 30, 2013 would decrease the fair value of debt by \$124.2 million, and a decrease in interest rates of 10% at September 30, 2013 would increase the fair value of debt by \$135.6 million at that date.

**Revolving and Term Loan Credit Agreements**

At September 30, 2013, we had a consolidated total of \$474.1 million outstanding under our revolving and term loan credit agreements, which are variable rate loans and fair value approximates book value. A 10% increase or decrease in borrowing rates under the revolving and term loan credit agreements compared to the weighted average rates in effect at September 30, 2013 would increase or decrease the total interest expense by \$0.6 million, respectively, for an annual period on a constant borrowing level of \$474.1 million.



Table of Contents

Derivative Instruments and Hedging Activities

We use derivative financial instruments, including interest rate swap contracts, to manage our exposure to fluctuations in interest rates. The use of these financial instruments mitigates exposure to these risks and the variability of our operating results. We are not a party to leveraged derivatives and do not enter into derivative financial instruments for trading or speculative purposes. During the second quarter of 2013, we settled and terminated \$250.0 million and \$225.0 million of 10-year and 30-year term interest rate swaps, respectively, in conjunction with the Senior Notes issued at ITC Holdings. See Note 5 to the condensed consolidated financial statements.

Other

As described in our Form 10-K for the fiscal year ended December 31, 2012, we are subject to commodity price risk from market price fluctuations, and to credit risk primarily with Detroit Edison, Consumers Energy and IP&L, our primary customers. There have been no material changes in these risks during the nine months ended September 30, 2013.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that material information required to be disclosed in our reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, with a company have been detected.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the three months ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

For information regarding risk factors affecting us, see "Item 1A Risk Factors" of our Form 10-K for the fiscal year ended December 31, 2012. There have been no material changes to the risk factors set forth therein.



Table of Contents

## ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth the repurchases of common stock for the quarter ended September 30, 2013:

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program (b)	Maximum Number or Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (b)
July 2013	958	\$92.66	—	—
August 2013	2,117	91.43	—	—
September 2013	2,069	89.62	—	—
Total	5,144	\$90.93	—	—

(a) Shares acquired were delivered to us by employees as payment of tax withholding obligations due to us upon the vesting of restricted stock.

(b) We do not have a publicly announced share repurchase plan.

Table of Contents

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report (unless otherwise noted to be previously filed, and therefore incorporated herein by reference). Our SEC file number is 001-32576.

Exhibit No.	Description of Document
4.34	First Supplemental Indenture, dated as of July 3, 2013 between ITC Holdings Corp and Wells Fargo Bank, National Association, as trustee (including forms of notes) (filed with Registrant's Form 8-K on July 3, 2013)
4.35	Fifth Supplemental Indenture, dated as of August 7, 2013, between International Transmission Company and The Bank of New York Mellon Trust Company, N.A. (as successor to BNY Midwest Trust Company), as trustee (including form of bonds) (filed with Registrant's Form 8-K on August 16, 2013)
10.119	Term Loan Credit Agreement, dated as of July 11, 2013, among International Transmission Company, various financial institutions, and Barclays Bank PLC, as administrative agent (filed with Registrant's Form 8-K on July 15, 2013)
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Database
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

Table of Contents

SIGNATURES

Pursuant to the requirements 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.

Dated: October 31, 2013

ITC HOLDINGS CORP.

By: /s/ Joseph L. Welch  
Joseph L. Welch  
President and Chief Executive Officer  
(duly authorized officer)

By: /s/ Cameron M. Bready  
Cameron M. Bready  
Executive Vice President and Chief Financial Officer  
(principal financial officer and principal accounting officer)