

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
and Jon Wellinghoff.

ITC Holdings Corp.
International Transmission Company
Michigan Transco Holdings, Limited
Partnership
Michigan Electric Transmission
Company, LLC
Trans-Elect NTD Path 15, LLC

Docket No. EC06-123-000

ORDER CONDITIONALLY AUTHORIZING DISPOSITION
AND ACQUISITION OF JURISDICTIONAL FACILITIES

(Issued September 21, 2006)

1. On May 19, 2006, ITC Holdings Corp. (ITC Holdings), International Transmission Company (ITC Transmission), Michigan Transco Holdings Limited Partnership (Michigan Transco), Michigan Electric Transmission Company, LLC (METC) and Trans-Elect NTD Path 15, LLC (NTD Path 15) (collectively, Applicants) filed a joint application under section 203 of the Federal Power Act (FPA)¹ for authorization of the indirect acquisition and disposition of jurisdictional facilities (the Transaction). Specifically, the application requests approval for the direct and indirect acquisition by ITC Holdings of 100 percent of the ownership interests in Michigan Transco, the parent company of METC, and for an intra-corporate reorganization of certain owners of METC and NTD Path 15 that would occur before the closing of the ITC Holdings acquisition transaction (the Reorganization). The Commission has reviewed the proposed Transaction and Reorganization under the

¹ 16 U.S.C. § 824b (2000), *amended by* Energy Policy Act of 2005 (EPAAct 2005), Pub. L. No. 109-58, § 1289, 119 Stat. 594 (2005).

Merger Policy Statement² and orders implementing EPAct 2005's amendments to section 203.³ We will authorize the Transaction and the Reorganization, subject to certain conditions to protect ratepayers. We find that, as conditioned by the Commission, the Transaction and the Reorganization will not have an adverse effect on competition, rates, or regulation and thus are consistent with the public interest, and that they will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company.

I. Background

A. Description of the Parties

1. ITC Holdings

2. ITC Holdings is a holding company with material assets consisting of 100 percent of common stock of ITC Transmission, certain deferred tax assets, and cash on hand. Controlling interest in ITC Holdings is held by International Transmission Holdings Limited Partnership (the Partnership). The Partnership is managed by its general partner, Ironhill Transmission, LLC, and has issued limited partnership interests to investment partnerships managed and advised by affiliates of Kohlberg Kravis Roberts & Co. L.P.; investments partnerships managed and advised by affiliates of Trimaran Capital Partners, L.L.C.; and Stockwell Fund, L.P.

² See *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); see also *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (2001), 94 FERC ¶ 61,289 (2001).

³ See also *Transactions Subject to Federal Power Act Section 203*, Order No. 669, 71 Fed. Reg. 1348 (2006), FERC Stats. & Regs. ¶ 31,200 (2006), *order on reh'g*, Order No. 669-A, 71 Fed. Reg. 28,422 (2006), FERC Stats. & Regs. ¶ 31,214 (2006), *order on reh'g*, Order No. 669-B, 71 Fed. Reg. 42,579 (July 27, 2006), FERC Stats. & Regs. ¶ 31,225 (2006). Order 669-A does not apply to this case because Applicants filed their application before the order became effective, which was June 25, 2006.

2. ITC Transmission

3. ITC Transmission is the wholly-owned operating subsidiary of ITC Holdings and is engaged exclusively in the transmission of electricity throughout Michigan, including the Detroit metropolitan area. It provides open, non-discriminatory access to its transmission facilities. ITC Transmission operates as an independent stand-alone transmission company and is a member of the Midwest Independent Transmission System Operator, Inc. (the Midwest ISO). The Midwest ISO has functional control of ITC Transmission's facilities.

4. ITC Transmission's assets include: 1) approximately 2,700 circuit miles of overhead and underground transmission lines rated at 120 kilovolts (kV) to 345 kV; 2) approximately 17,000 transmission towers and poles; 3) 30 stations that connect transmission facilities; 4) other transmission equipment necessary to safely operate the system; 5) associated land, rights of way and easements; 6) certain assets located in ITC Transmission's Novi, Michigan corporate office, which consists of a transmission operations control room, furniture, fixtures and office equipment; and 7) the Michigan Electric Power Coordination Center, which performs control area services for all of the electrical systems of ITC Transmission and METC.

3. Michigan Transco

5. Michigan Transco's only business is its sole ownership of METC. Trans-Elect Michigan, LLC (Trans-Elect Michigan) is the general partner of Michigan Transco and a wholly-owned subsidiary of Trans-Elect, Inc. (Trans-Elect).⁴ Trans-Elect Michigan holds a 15 percent partnership interest in Michigan Transco and is responsible for managing and operating Michigan Transco's business.⁵ Michigan Transco's limited partners include Evercore METC Investment Inc. and Evercore METC Co-Investment Inc.

⁴ Trans-Elect is the wholly-owned subsidiary of Trans-Elect Holding Company (TE Holding). TE Holding is owned by management shareholders and TE Power Opportunities Investors L.P. (TE Investors). TE Holding is also the ultimate parent company of METC and NTD Path 15.

⁵ According to Applicants, the management services provided by Trans-Elect are governed by a Management Services Agreement with METC that will terminate upon consummation of the Transaction. Transmittal Letter at 9.

(together, the Evercore Investors);⁶ Macquarie Transmission Michigan Inc.;⁷ NA Capital Holdings Inc.;⁸ and Mich 1400 Corp.⁹

4. METC

6. METC is the wholly-owned operating subsidiary of Michigan Transco. Its only business is the independent ownership, management and expansion of transmission facilities. METC does not own generation, buy or sell energy, or otherwise participate in energy markets. Its transmission assets include approximately 5,400 miles of 345 kV and 138 kV transmission lines, as well as circuit breakers, transformers and 80 substations. METC's transmission facilities serve customers in the Lower Peninsula of Michigan. METC is a member of the Midwest ISO and its assets are under the Midwest ISO's control.

5. NTD Path 15

7. Trans-Elect indirectly owns partial interests in NTD Path 15, an FPA-jurisdictional public utility formed to help finance the construction of the "Path 15" transmission facility upgrades in California (Path 15 Upgrade Project). NTD Path 15 has a contractual entitlement to a portion of the transmission system rights (TSRs) resulting from the Path 15 Upgrade Project. According to Applicants, "NTD Path 15 manages its interests in the TSRs."¹⁰ NTD Path 15 does not own or operate any electric transmission, generation, or distribution facilities, nor does it engage in the sale or brokering of energy or ancillary services. All membership interests in NTD Path 15 are held by Trans-Elect NTD Holdings Path 15, LLC (NTD Path 15 Holdings), which is a limited liability company. New Transmission Development Company, a wholly-owned subsidiary of Trans-Elect, owns the common membership interest and a portion of the preferred membership interests in NTD Path 15 Holdings.

⁶ The Evercore Investors are owned by affiliates of Evercore Capital Partners II L.P.

⁷ Macquarie Transmission Michigan Inc. is owned by affiliates of Macquarie Essential Assets Partnership. It was formed to hold Macquarie Essential Asset Partnership's investments in Michigan Transco.

⁸ NA Capital Holdings Inc. is owned by affiliates of the Macquarie Group, which is an Australian-based investment bank that specializes in infrastructure projects. Macquarie Bank Limited is the parent company of Macquarie Group.

⁹ Mich 1400 Corp. is owned by Mich 1400 LLC. Evercore Investors, Macquarie Transmission Michigan Inc., NA Capital Holdings Inc., and Mich 1400 Corp. collectively acquired 85 percent limited partnership interests in Michigan Transco. Transmittal Letter at 10 (citing *Michigan Transco Holdings, Ltd. P'ship*, 105 FERC ¶ 62,013 (2003)).

¹⁰ Transmittal Letter at 11.

B. The Proposed Transaction

8. The Transaction involves ITC Holdings acquiring all of the general and limited partnership interests in Michigan Transco, which wholly owns METC. ITC Holdings will therefore indirectly acquire METC. The Reorganization of the Trans-Elect entities will occur as well in order to complete the Transaction.

9. The companies involved in the Transaction include TE Holding, Trans-Elect, Trans-Elect Michigan, Michigan Transco, and METC. TE Holding is the parent company of Trans-Elect, and Trans-Elect is the owner of Trans-Elect Michigan. Trans-Elect Michigan is the general partnership interest in Michigan Transco. Michigan Transco is the sole owner of METC. The Transaction will include the creation of a new corporate entity, NewCo, to replace Trans-Elect and its parent TE Holding, as the owner of Trans-Elect Michigan. NewCo's sole asset will be Trans-Elect Michigan. The Trans-Elect entities will reorganize on or about the day before the closing of the Transaction. ITC Holdings will then acquire 100 percent of the ownership interests in NewCo, resulting in NewCo becoming a direct, wholly-owned subsidiary of ITC Holdings. Trans-Elect Michigan will be an indirect, wholly-owned subsidiary of ITC Holdings.

10. ITC Holdings will acquire all of the limited partnership interests in Michigan Transco through the acquisition of the following corporations that hold limited partnership interests in Michigan Transco on behalf of their parent entities: Evercore METC Investment Inc., Evercore METC Co-Investment, Inc., Macquarie Transmission Michigan Inc., NA Capital Holdings Inc., and Mich 1400 Corp. ITC Holding's acquisition of NewCo and then of the limited partnership interests in Michigan Transco will result in ITC Holdings indirectly acquiring 100 percent ownership in METC.

11. The Transaction does not alter METC's status as a separate transmission company in a separate Midwest ISO rate zone. METC's operations in the ordinary course of business will continue substantially the same as before. METC's Management Services Agreement with Trans-Elect, however, will be terminated as part of the Transaction.

C. Description of the Reorganization

12. The Reorganization must occur before the Transaction because TE Holding's and Trans-Elect's non-METC businesses, such as their interests in NTD Path 15, will not be transferred to ITC Holdings as part of the Transaction. The proposed Reorganization is an intra-corporate reorganization that will separate Trans-Elect's and TE Holding's indirect partial ownership interests in METC from their interests in non-METC businesses. The separation of METC and non-METC businesses will occur through the formation of NewCo and a series of contemporaneous steps that will result in: 1) NewCo owning Trans-Elect Michigan and indirectly, a partial interest in METC, and 2) TE

Holding and Trans-Elect converting into limited liability companies owning the non-METC businesses, including NTD Path 15. The owners of METC and NTD Path 15 will not change because TE Holding's owners will be the owners of NewCo and will continue their ownership interests in TE Holding.

13. The proposed Reorganization will occur in six steps. The first two steps are the formation of NewCo and TE Holding becoming a wholly-owned subsidiary of NewCo. The owners of TE Holding, the management shareholders and TE Investors, will form NewCo. For step two, the management shareholders and TE Investors will contribute their stock in TE Holding to NewCo, in exchange for common stock in NewCo. The proportions of stocks exchanged will substantially correspond to the proportions of the management shareholder's and TE Investor's ownership in TE Holding. TE Holding will become a wholly-owned subsidiary of NewCo.

14. The third and fourth steps involve TE Holding and Trans-Elect converting from corporations into limited liability companies (LLCs). In step three, TE Holding will convert from a Michigan Corporation to a Michigan limited liability company and be renamed Trans-Elect Holding LLC (TE Holding LLC). TE Holding LLC will first be formed into an LLC subsidiary of NewCo with no assets and then will merge with TE Holding, leaving TE Holding LLC as the surviving company. For step four, Trans-Elect will complete the same conversion from a corporation to an LLC. This conversion will occur by the formation of Trans-Elect LLC with no assets. Then Trans-Elect will merge with Trans-Elect LLC. Trans-Elect LLC will become the wholly-owned subsidiary of TE Holding LLC.

15. The fifth and sixth steps involve Trans-Elect LLC giving NewCo its interests in Trans-Electric Michigan, and NewCo giving the management shareholders and TE Investors full ownership of TE Holding LLC. In step five, Trans-Elect LLC will distribute all of its membership interests in Trans-Electric Michigan to TE Holding LLC, which will then distribute its membership interests in Trans-Electric Michigan to NewCo. The result is that Trans-Electric Michigan will be the wholly-owned subsidiary of NewCo and no longer a subsidiary of TE Holding LLC or Trans-Elect LLC. For step six, NewCo will distribute its membership interests in TE Holding LLC to the management shareholders and TE Investors, so they will become direct owners of TE Holding LLC. Both management shareholders and the TE Investors will own shares proportionate to what they owned in TE Holding.

16. The ultimate result of the Reorganization is that the original owners of TE Holding, the management shareholders and TE Investors, will retain their indirect ownership of: 1) NTD Path 15 through TE Holding LLC (formerly TE Holding) and 2) METC through their ownership of NewCo. TE Holding LLC will continue to own Trans-Elect LLC (formerly Trans-Elect, Inc.), which holds interests in NTD Path 15 and other non-METC business. However, TE Holding LLC will no longer own any direct

interests in Trans-Elect Michigan or indirect interests in METC. NewCo will own only Trans-Elect Michigan and all of TE Holding's and Trans-Elect's prior indirect interests in Michigan Transco and METC.

II. Notice of Filing and Responsive Pleadings

17. Notice of Applicants' filing was published in the *Federal Register*, 71 Fed. Reg. 32,336 (2006), with comments, protests or interventions due on or before June 12, 2006.

18. A timely motion to intervene and reject the application and timely protests were filed by Michigan Public Power Agency, Michigan South Central Power Agency, and Consumers Energy Company (CECo). Timely motions to intervene were filed by American Transmission Company LLC, and Wolverine Power Supply Cooperative, Inc. A timely notice of intervention and protest was filed by Michigan Public Service Commission (Michigan PSC). Applicants filed an answer to the motion to intervene and reject the application, and answers to the motions to intervene and protests. Michigan PSC also filed an answer.

III. Discussion

A. Procedural Matters

19. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

20. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2)(2006), prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We will accept Applicants' answers because they have provided information that assisted us in our decision-making process. We will also accept Michigan PSC's answer because it provided information that assisted us in our decision-making process.

B. Standard of Review Under Section 203

21. Section 203(a) of the FPA provides that the Commission must approve a disposition of facilities if it finds that the disposition "will be consistent with the public interest."¹¹ The Commission's analysis of whether a disposition is consistent with the public interest generally involves consideration of three factors: (1) the effect on

¹¹ 16 U.S.C. § 824b(a)(4) (2000).

competition; (2) the effect on rates; and (3) the effect on regulation.¹² EAct 2005 amended section 203 to specifically require that the Commission also determine that the disposition will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest.¹³

22. The Reorganization is an intra-corporate reorganization, is only designed to enable the Transaction to occur, and has no effects separate from those of the Transaction. Therefore, our discussion below of the Transaction applies to the Reorganization as well.

C. Effect on Competition

1. Arguments

23. Applicants state that the Transaction will have no adverse effect on competition and does not require a horizontal or vertical analysis. Applicants note that after the Transaction, the transmission facilities of both ITC Transmission and METC will continue to be under the control of the Midwest ISO, and they will provide open, non-discriminatory access to their systems under the Midwest ISO Transmission and Energy Markets Tariff (TEMT). After the Reorganization, all use of the Path 15 Upgrade transmission facilities associated with NTD Path 15's transmission system rights will stay under California Independent System Operator Corporation (CAISO) control, with open, non-discriminatory access provided pursuant to the CAISO tariff. Thus, Applicants assert that, as open access to and continued independent operation of the systems by the Midwest ISO and CAISO is secure, the Transaction will not have any adverse effect on competition. Furthermore, Applicants state that there is no need for a horizontal market analysis because the Transaction involves the transfer of ownership interests in a transmission-only utility and the Reorganization is only an intra-corporate reorganization. Applicants also maintain that none of the Applicants either indirectly or indirectly owns or controls generating assets, and none is or will be affiliated with any market participants.

24. Additionally, Applicants state that the Transaction does not require a vertical competition analysis. Applicants maintain that the Reorganization will not result in any vertical market power concerns, as it is an intra-corporate reorganization with only limited changes in the corporate structure of the owners of METC and NTD Path 15.

¹² See *Merger Policy Statement*, see also Order No. 669.

¹³ EAct 2005, § 1289, 119 Stat. 594, at 982-83 (2005) (to be codified at 16 U.S.C. § 824b(a)(4)).

2. Commission Determination

25. Applicants have shown that the Transaction will not harm competition in any relevant market. Applicants' transmission facilities are under the operational control of the Midwest ISO, and they do not own or control generating assets, and are not affiliated with any market participants. No party asserted that the merger would adversely affect competition.

D. Effect on Rates

1. Arguments

26. Applicants claim that there will be no adverse effect on rates resulting from the Transaction because ITC Transmission and METC will charge rates under the ITC Transmission Attachment O rate formula and the METC Attachment O rate formula on file with the Commission. Applicants argue that the rates will not change in any way due to the transaction and state that they will not seek recovery of any goodwill or transaction premium in the rates. Applicants also assert that there will be no adverse effect on rates due to the Reorganization because it is an upstream corporate reorganization that does not change the business or operations of NTD Path 15 and consequently does not affect the rates or rate treatments applicable to NTD Path 15.

27. Michigan PSC argues that the Applicants have not shown or committed that the Transaction will not have an adverse effect on rates. It argues that the Commission should require the Applicants to submit further information as to how they will ensure that the merger will not result in net increases in rates. Michigan PSC notes that in lieu of proposing specific mechanisms to ensure that the rates are not adversely affected, the Applicants simply assert that the Transaction will have no adverse effect on rates because both METC and ITC Transmission will continue to use their Attachment O formula rates. However, the continued use of the Attachment O formula rate does not mean that there will be no adverse effect on rates. It argues that since the Attachment O formula rate is a cost-of-service rate, it is possible for merger-related cost increases to flow through the formula to the customers.

28. Michigan PSC further notes that while the Applicants promise not to seek recovery of any goodwill or acquisition premium associated with the Transaction, they do not address whether the Transactions may increase costs, do not claim cost savings resulting from economics of scale and/or elimination of duplicative functions, and do not attempt to show that potential merger benefits would outweigh any cost increases.

29. Additionally, Michigan PSC states that there is evidence that the Transaction will have a direct effect on some costs and that more information is needed to ascertain whether this will lead to merger-related rate increases to the customers. Michigan PSC

asserts that the refinancing of long-term debt proposed by METC in connection with the Transaction could result in an increase in METC's debt costs if the interest rates on the new debt are higher than the current rates or if the prepayment/issuance costs are significant. Furthermore, Michigan PSC states that Standard & Poor's placed "BBB" credit ratings of ITC Holdings and ITC Transmission on credit review with negative implications as a result of the Transaction, which, in turn, could increase the debt cost of ITC and METC by increasing the risk premium required by investors.

30. Michigan PSC also expresses concern about the Management Services Agreement between METC and Trans-Elect, an affiliate, under which METC pays Trans-Elect an annual service fee for certain executive/managerial support and regulatory services. Michigan PSC is concerned because METC has defended the recovery of Management Services Agreement costs in a pending rate case on the grounds that the costs incurred under the Management Services Agreement are less than costs incurred without the Management Services Agreement. Thus, since the Management Services Agreement will terminate and there will be no similar agreement following the transaction, Michigan PSC argues that there might be a cost increase associated with the services provided by Trans-Elect under the Management Services Agreement.

31. Finally, Michigan PSC states that ITC Transmission has recently filed to modify Attachment O to allow the use of current projected expenses in rate base, raising concerns that METC, as an affiliate of ITC after the Transaction, may do so as well. Such adjustments could have an adverse effect on rates.

32. To alleviate these concerns, Michigan PSC suggests that the Commission direct the Applicants to provide additional information regarding expected merger-related costs and savings and allow the Applicants to explain how any merger-related cost increases could be offset by merger-related benefits. It alternatively suggests that the Commission permit the Applicants to propose a ratepayer protection mechanism.

a. Applicants' Answer to Michigan PSC

33. In their answer to Michigan PSC's protest, Applicants state that Michigan PSC does not raise any issue that should delay the Commission's full approval of the Transaction and related Reorganization. They note that Michigan PSC seeks an analysis of merger costs and benefits, which does not accurately portray the Transaction at issue, as the Transaction is the indirect acquisition of METC by ITC Holdings, not a merger.

34. Regarding the refinancing of the METC debt, Applicants state that the reason for the refinancing is to address covenants that restrict METC's ability to make greater investments in its transmission system, not to allow the Transaction to occur. For instance, covenants in METC's current debt agreements do not allow METC to make capital investments in its system until after a final, unappealable decision is made in its

pending rate case, with an exception for reasonably necessary expenditures. Applicants also note that METC is only able to borrow a limited additional amount under its current debt agreements, which Applicants feel does not adequately support its near-term capital investments, maintenance, need and working capital requirements. Applicants assert that the removal of these restrictive covenants will enhance METC's ability to invest in its system to improve its performance. ITC Holdings could seek permission to address METC's debt at a later date, but chose to do so now to avoid delays in making investments in the transmission grid. Thus, they contend that any changes in METC's debt cost due to refinancing would not be a direct result of the transactions. Furthermore, Applicants state that they would proceed with the Transaction even without approval of the refinancing.

35. As to Michigan PSC's concerns about the potential increase in debt costs due to a change in the credit rating of ITC Holdings and ITC Transmission, Applicants argue that ITC Holdings' credit rating has not been downgraded and claim that Michigan PSC's concerns are speculative. They assert that ITC Holdings being put on credit watch by Standard & Poor's upon its announcement of its agreement to acquire METC does not mean that ITC Transmission will experience increased debt expense. To counterbalance Michigan PSC's claim, Applicants refer to Moody's, which rates both METC and ITC Holdings/ITC Transmission, as a more accurate indicator of the probable effect of the transaction on debt costs. According to Applicants, Moody's reaffirmed the rating of ITC Holdings/ITC Transmission and METC, indicating that a negative turn in credit ratings is not a concern.

36. Applicants argue that the termination of the Management Services Agreement will not have an adverse effect on rates because METC will not need to replace the services currently provided by Trans-Elect with those provided by an unaffiliated provider. They state that ITC Holdings will provide financial services and other coordinated management functions if necessary under a management system that encompasses ITC Transmission and METC.

37. Regarding Michigan PSC's claim that Applicants have not shown the Transaction to have no adverse effect on rates, Applicants assert that the Transaction does not change METC's status as a separate company or METC's Commission-approved Attachment O formula rate. They cite Commission rulings that state that the "formula alone constitutes the filed rate" and consequently conclude that, as they have not proposed any changes in the Attachment O formula rate, the Transaction can have no adverse rate effect. Applicants do indicate that ITC Transmission has sought permission to change the calculation of its Attachment O revenue requirement from a lagging to a current basis in a separate docket, as Michigan PSC pointed out, but they argue that this change has no bearing on this proceeding. Moreover, Applicants contend that the proposed change would not have an adverse effect on ITC Transmission's rates in any case, as the formula rates would be designed to recover only its cost of service. Applicants also challenge

Michigan PSC's concern that METC may attempt to adjust its own Attachment O formula rate in the future, since the future change would be subject to Commission approval under section 205.

38. Applicants also emphasize that they have agreed not to seek recovery of any acquisition premium associated with the Transaction through rates. They argue that this is similar to the *American Transmission Company LLC* case,¹⁴ in which the Commission approved the acquisition of jurisdictional facilities where ratepayer protection was provided because facilities were transferred at their current net book value.

39. Furthermore, Applicants state that the Commission has continuing oversight over the rates of METC and ITC Transmission and will be able to directly address the protesters' concerns at any time. Thus there is no basis to require the submission of further information or to delay the approvals requested in the Application. Applicants assert that section 203 applicants are not required to demonstrate that their proposal provides benefits. However, as the Transaction brings two independent transmission companies under the common ownership of one holding company, increasing the size and scope of the companies' operations, the Transaction is consistent with and promotes the public interest. Applicants argue that the Transaction will benefit the public interest by helping to facilitate coordinated transmission operation and planning for upgrades of a greater size and scope, as well continue a good record of investment for the METC and ITC Transmission transmission systems.

b. Michigan PSC's Response

40. Michigan PSC, in its response to the Applicants' answer, refutes the Applicants' assertion that the Transaction cannot have an adverse effect on rates because the "formula alone constitutes the filed rate." Michigan PSC argues that this principle is irrelevant in this case. The concern is whether the customers will be protected from costs related to the Transaction flowing automatically through a formula rate; for this reason, the cases cited by Applicants are inapplicable.

41. In response to Applicants' argument that the specific cost items identified by Michigan PSC could not adversely affect rates, Michigan PSC points out that the burden is on the Applicants to show how they will hold ratepayers harmless. Michigan PSC notes that Applicants have only argued that the refinancing is not being done to enable the Transaction; they do not deny that METC's proposed refinancing might increase its debt costs. Michigan PSC also asserts that Applicants' previous statements show that the Transaction and refinancing are integrally related. Michigan PSC quotes previous METC statements in which METC indicated that the removal of the restrictive covenants is appropriate to realize the benefits of the indirection acquisition by ITC Holdings and that

¹⁴ 108 FERC ¶ 62,140 (2004).

the change of control provisions could be triggered by the Transaction, which could give rise to a default of METC's debts unless METC obtains ratings reaffirmation of its rating.¹⁵

42. Michigan PSC also asserts that Applicants have not offered more concrete ideas concerning the increased investment that would be facilitated by refinancing METC's debt and the extent to which the benefit of this investment would justify any increases in borrowing costs. Thus, Michigan PSC maintains that Applicants should provide more detailed information regarding the benefits, costs, and savings they anticipate from the acquisition.

43. As to Standard & Poor's placement of the ITC Holdings and ITC Transmission on credit watch with negative implications, Michigan PSC reaffirms that it is an issue for concern. Although Michigan PSC concedes that ITC Holdings' and ITC Transmission's credit ratings have not been downgraded, it notes that the Standard & Poor's announcement, by definition, has negative implications for the credit ratings, and as such could increase the risk premium required by investors, which would increase the debt cost of ITC and METC.

44. Finally, regarding the Management Services Agreement and management services, Michigan PSC argues that although the Applicants state that ITC Holdings' overall management costs may be spread across both METC and ITC Transmission, this does not guarantee that the portion allocated to METC will be less than METC's management costs under the Management Services Agreement.

2. Commission's Determination

45. The Merger Policy Statement states that applicants should propose ratepayer protection mechanisms to ensure that a transaction will not adversely affect wholesale electricity or transmission rates. The Policy Statement advises that the most promising and expeditious means of addressing ratepayer protection is for the parties to negotiate an agreement on ratepayer protection mechanisms. The applicant bears the burden of proof to demonstrate that the customer will be protected. The Policy Statement recommends four particular ratepayer protection mechanisms: (1) a hold harmless provision; (2) an open season; (3) a rate freeze; and (4) a rate reduction.

46. Where the rates are formula rates, the Commission has accepted rate protection mechanisms such as the hold harmless provision approved by the Commission in *Consolidated Edison*:

¹⁵ METC Answer at 4.

...Applicants commit that they will not seek to recover the merger acquisition premium and other merger-related costs through rates until they have obtained specific regulatory authority to do so. Third, the Applicants commit that, with respect to transmission rates, they will not include merger-related costs in those rates without: (1) specifically identifying them; (2) demonstrating that the costs included in the rates are exceeded by the savings produced by the merger; and (3) in the event of a dispute, bearing the burden of proof that the merger savings exceed the merger costs charged to the customer.¹⁶

47. Here, Applicants have not provided such a comprehensive hold harmless agreement. Rather, they have stated that they will not recover any transaction premium, and that the rates will remain formula rates under Attachment O of the Midwest ISO tariff. We agree with the Michigan PSC that the Applicants have not adequately shown that the Transaction will not adversely affect transmission rates. The inputs to the formula rates could change as a result of the Transaction, which could adversely affect transmission rates.

48. Therefore we will condition our section 203 authorization on Applicants providing ratepayer protection consistent with the hold harmless provision approved by the Commission in *Consolidated Edison*. If Applicants seek to recover merger-related costs through their transmission rates, they must submit an informational filing to the Commission that details how they are satisfying the hold harmless requirement. In particular, in such a filing, Applicants must: (1) specifically identify the merger-related costs they are seeking to recover, and (2) demonstrate that those costs are exceeded by the savings produced by the merger. We have found the hold harmless commitment to be enforceable and administratively manageable in the formula rate context if customers have the opportunity to scrutinize costs before they are included in the formula rate, and therefore are able to alert the Commission to costs that, contrary to Applicants' commitments, might be merger-related. Such a hold harmless commitment would not require changes to the Applicants' formula rate, but will protect customers' wholesale rates from being adversely affected by the merger.

3. CECo

a. CECo's Protest Regarding Reductions in Management, Administrative, and General Costs

49. CECo argues that the merger of the two transmission companies would lead to significant reductions in management, administrative, and general costs, and that any such cost reductions should be reflected in the merged company's Midwest ISO

¹⁶ *Consolidated Edison, Inc.*, 94 FERC ¶ 61,079 (2001).

Attachment O formula rate.¹⁷ It states that the Commission should require ITC Holdings to provide detailed estimates of projected cost savings that are expected to result from the combined ownership of the METC and ITC Transmission transmission systems. It also states that the Commission should require the merged transmission company to make informational filings with the Commission every year quantifying the costs savings produced by the merger in the previous calendar year to allow CECo to determine whether any cost savings that result from the merger have been properly reflected in CECo's transmission rates.

i. Applicants' Answer to CECo

50. Applicants state that ITC Holdings has made no specific savings estimates for the Transaction. Accordingly, the Commission should reject CECo's request for "detailed estimates of projected cost savings" before this Application is approved.¹⁸

ii. Commission Determination

51. Any effect on rates related to cost savings is addressed in our condition that transmission rates not include merger-related costs without: (1) specifically identifying them; (2) demonstrating that the costs included in the rates are exceeded by the savings produced by the merger; and (3) in the event of a dispute, bearing the burden of proof that the merger savings exceed the merger costs charged to the customer. Applicants are not required under section 203 to share all merger-related benefits with wholesale customers. Rather, they are required to provide ratepayer protection so that wholesale customers are not harmed by the merger. In particular, in order to justify including any merger-related costs in transmission rates, they must show offsetting merger-related benefits. In addition, if the Transaction results in lower costs in the future, they will be reflected in the Midwest ISO Attachment O formula rate and transmission customers will have adequate opportunity to review the cost inputs in the rate. We addressed the issue of customers' ability to review Midwest ISO Attachment O cost inputs in *International Transmission Company*¹⁹ and found that ITC's customers would have ample opportunity to review those inputs. Therefore, we will not require Applicants to provide estimates of future cost savings, as requested by CECo.

¹⁷ CECo Protest at 7.

¹⁸ Answer at 11.

¹⁹ 116 FERC ¶ 61,036, at P 21 (2006).

b. **CECo's Protest that METC Customers Should not Have to Pay Management Services Agreement Termination Payment**

52. CECo notes that Applicants propose to terminate METC's Management Services Agreement with Trans-Elect and pay the Management Services Agreement Termination Amount to Trans-Elect at the Closing. CECo argues that METC's customers should not be required to pay the cost of METC's termination payment to its corporate parent.

i. **Applicants' Answer to CECo**

53. Applicants agree that METC will not seek to recover the costs of buying out the Management Services Agreement from its customers.²⁰

ii. **Commission Determination**

54. We find that any concern related to the Management Services Agreement termination fee is eliminated by Applicants' commitment that METC will not seek to recover the costs of buying out the Management Services Agreement from its customers. We rely on that commitment in authorizing the Transaction.

c. **CECo's Protest that METC Customers Should Not Have to Pay Increased Costs**

55. CECo notes that on the same day the Application was filed, METC filed an application in Docket No. ES06-49-000 requesting authorization to issue new debt to replace existing debt. CECo does not oppose that refinancing, but believes that it should not pay increased rates due the rate on the new debt securities being higher than the rate on the existing debt. It argues that because the refinancing is being undertaken solely to allow ITC Holdings to purchase METC, the increased costs that will result from this refinancing should not be paid by METC's customers.

i. **Applicants' Answer to CECo**

56. Applicants state that the refinancing by METC of its outstanding debt is not necessary for the Transaction, but is proposed to be completed in conjunction with the Transaction to enable increased transmission investment in METC. They also say that it will not adversely affect wholesale customers. If the Commission nevertheless determines that the proposed refinancing would cause an adverse effect on METC's rates, such that the Transaction cannot be approved or must be conditioned as proposed by CECo, then the Applicants will not pursue the refinancing. However, this would be contrary to the public interest because, while the Transaction could be undertaken

²⁰ Answer at 10.

without the proposed METC refinancing, the benefits of greater investment in METC's system would be delayed.²¹

ii. Commission Determination

57. Any adverse effect on rates related to the issuance of new securities is addressed in our condition that transmission rates will not include merger-related costs without: (1) specifically identifying them; (2) demonstrating that the costs included in the rates are exceeded by the savings produced by the merger; and (3) in the event of a dispute, bearing the burden of proof that the merger savings exceed the merger costs charged to the customer.

d. CECo's Protest that Acquisition Premium Should Not be Reflected in Future Rates Charged by METC

58. CECo argues that a \$53.7 million acquisition premium recorded by METC in connection with the transactions approved in Docket No. EC03-132-000 should not be reflected in future rates charged by METC or any successor because: (1) before the transactions METC represented in its application in Docket No. EC03-132-000 that there would not be a significant impact on rates; (2) METC committed in Docket No. EC05-52-000, after the transactions, that the Docket No. EC03-132-000 acquisition premium would not affect rates unless they made a section 205 application; and (3) the Applicants in this case commit that "[w]ith respect to the Transaction, as detailed in Exhibit N, the proposed accounting treatment for Transaction will not recover through rates any goodwill related amounts."²²

i. Applicants' Response to CECo

59. In response to CECo's concern about goodwill related to the transaction in Docket No. EC03-132, Applicants state that Exhibit N-2 to the Application shows journal entries that are consistent with METC's FERC Form 1 reporting. Also, consistent with how METC has treated that goodwill, adjustments will be made to eliminate the effect of the push-down accounting of that goodwill from METC's equity balance for purposes of its Attachment O calculation. They therefore conclude that CECo's concern that the \$53.7 million in goodwill from the transaction approved in Docket No. EC03-132 will not be adjusted out of METC's equity balance for purposes of METC's Attachment O calculation, is unfounded.²³

²¹ *Id.* at 8-9.

²² CECo Protest at 3-4.

²³ Answer at 13.

ii. **Commission Determination**

60. We reject CECo's argument regarding the recovery of the acquisition premium recorded by METC in connection with the transactions approved in Docket No. EC03-132-000. Applicants have committed that the proposed accounting treatment for the Transaction will not recover any goodwill-related amount through rates, and we rely on that commitment in our finding that along with the hold harmless condition we are imposing, the merger will not adversely affect rates.

E. Effect On Regulation

61. Applicants state that the Transaction will have no adverse effect on regulation by the Commission or the State of Michigan. In particular, Applicants declare that after the Transaction, the Commission will continue to be able to regulate ITC Transmission's and METC's rates, terms and conditions of service to the same extent as before. METC and NTD Path 15 will continue to be subject to the Commission's jurisdiction, including the Commission's rate, financial and intra-corporate transaction regulation. Furthermore, according to the Applicants, Michigan PSC has authority over the siting of ITC Transmission's and METC's transmission lines and compliance with environmental standards and regulations, which will not change. Applicants claim that Michigan PSC does not have jurisdiction now over the rates, terms or conditions of service of ITC Transmission's or METC's facilities, so there is no such jurisdiction to be affected.

62. We find that the proposed Transaction will not adversely affect Commission or state regulation. The Commission will still be able to regulate ITC Transmission's and METC's rates, terms and conditions of transmission service to the same extent as before. The Michigan PSC does not have jurisdiction over the rates, terms or conditions of service of ITC Transmission's or METC's facilities, and will thus not be affected. We note that the Michigan PSC did not raise issues regarding the merger's effect on regulation.

F. Cross-Subsidization

63. Applicants state that the Transaction will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company. Applicants assert that since neither ITC Transmission, METC, nor NTD Path 15 are affiliated with Load Serving Entities, and they do not have affiliates that own generation or own generation themselves, there are no cross-subsidization concerns. Furthermore, Applicants argue that the Commission's principal concern in regard to cross-subsidization is the effect of a transaction on rates and, as the Transaction will have no adverse effect on rates, there are no concerns about improper cross-subsidization.

64. In particular, Applicants affirm that the Transaction will not result in any transfer of facilities between a traditional utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities and an associate company. The Transaction only involves direct changes of ownership and control of METC from its current owners to ITC Holdings and in a nominal change of the intermediate indirect owners of METC and NTD Path 15.

65. Applicants verify that the Transaction will not result in new issuances of securities for the benefit of an associate company. Only METC has filed for authorization pursuant to section 204 to refinance existing debt. Applicants contend that METC is only refinancing to remove restrictive covenants and has committed in its section 204 filing to four conditions imposed on the issuance of securities by the Commission in a previous case.²⁴

66. Applicants affirm that the Transaction will not involve pledges or encumbrances of utility assets for the benefit of an associate company, as the Transaction does not involve using utility assets to finance or serve as collateral for any activities of an associate company. Applicants state that the refinancing of METC's existing debt is not a new pledge of encumbrance for the benefit of an associate company because METC is only refinancing to remove restrictive covenants on its debt and is not proposing to increase its current level of authorized debt. Furthermore, Applicants argue that ITC Transmission and METC are subject to the Commission's cash management reporting requirement, which allows the Commission to guard against any improper pledges or encumbrances. Applicants also state that the Reorganization does not involve any pledges or encumbrances because it is a "nominal" intra-corporate reorganization of the upstream owners of METC and NTD Path 15.

67. Finally, Applicants verify that the Transaction will not result in any new affiliate contracts between non-utility associate companies. Applicants note that the only existing affiliate contract involving METC is a management services agreement between METC and Trans-Elect that will terminate once the transaction closes.

1. Commission's Determination

68. The concern about cross-subsidization is principally a concern over the effect of a transaction on rates. The Commission's focus has been on preventing a transfer of benefits from a traditional public utility's cost-based customers to shareholders of the public utility holding company due to an intra-system transaction that involves power or energy, generation facilities, or non-power goods and services.²⁵ Concerns can arise

²⁴ *Westar Energy, Inc.*, 102 FERC ¶ 61,186 (2003).

²⁵ Order No. 669 at 147. Order 669-A does not apply to this case, as explained in footnote 3.

when an “unregulated” affiliate (*e.g.*, a power marketer or non-utility affiliate) provides power or goods and services to a public utility with cost-based customers and when a public utility with cost-based customers provides power or goods and services to the “unregulated” affiliate. For instance, a traditional public utility with customers served at cost-based rates may purchase power from its marketing affiliate at a price above market or sell power to its marketing affiliate at below-market prices, thus transferring benefits from customers to shareholders of the holding company. Further, customers may be harmed if the traditional public utility purchases non-power goods and services from an affiliate at above market prices or sells non-power goods and services to an affiliate at less than the higher of cost or market value.²⁶

69. There is potential for abuse where the revenues of a public utility with cost-based customers are used to finance the operations of non-utility affiliates. In such cases, the cost of the utility service may be increased, and if the parent makes unwise investment decisions, the reliability of the jurisdictional facilities could be impaired.

70. As noted above, Applicants address the four-part test adopted in Order No. 669-A for evaluating cross-subsidization concerns. As demonstrated by the verifications above, the proposed Transaction does not raise any concern with respect to cross-subsidization. Most notably, Applicants do not have any cost-based captive customers who could be harmed by cross-subsidization of a non-utility affiliate. We further note that no protests regarding cross-subsidization were filed.

The Commission orders:

(A) The proposed Transaction is authorized, subject to Commission acceptance of the Applicants’ compliance filings as discussed in the body of this order.

(B) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates or determinations of costs, or any other matter whatsoever new pending or which may come before this Commission.

(C) The Commission retains the authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(D) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted;

²⁶ *Id.* at P 164-71. The discussion in Order No. 669 also refers to the Notice of Proposed Rulemaking for that order. *Transactions Subject to FPA Section 203*, Notice of Proposed Rulemaking (NOPR) at P 47, 70 FR 58,636 (October 7, 2005), FERC Stats. & Regs. ¶ 32,589 (2005).

(E) Applicants shall make appropriate filings under section 205 of the FPA, as necessary, to implement the Transaction.

(F) METC shall account for the acquisition of the facilities and must submit its proposed accounting within six months of the date that the transfer is consummated. In addition, the accounting submission must provide all accounting entries related to the acquisition that were made to the books and records, along with appropriate narrative explanations describing the basis for the entries.

(G) If Applicants seek to recover merger-related costs through their transmission rates, they must submit an informational filing to the Commission that details how they are satisfying the hold harmless requirement. In particular, in such a filing, Applicants must: (1) specifically identify the merger-related costs they are seeking to recover, and (2) demonstrate that those costs are exceeded by the savings produced by the merger.

(H) Applicants shall notify the Commission within 10 days of the date of the disposition and acquisition of jurisdictional facilities has been consummated.

By the Commission. Commissioner Moeller not participating.

(S E A L)

Magalie R. Salas,
Secretary