ITC Holdings Corp.
Form 10-Q
April 24, 2013

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

þ	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the Quarterly Period Ended March 31, 2013
OR	
o	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 þ No o
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 þ No o
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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
The number of shares of the Registrant's Common Stock, without par value, outstanding as of April 19, 2013 was 52,332,830.

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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;
- “ITCTransmission” 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 ITCTransmission, 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 ITCTransmission, 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 Edison 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);
- “MISO” are references to 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 ITCTransmission, 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.

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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)	March 31, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	$67,582	$26,187
Accounts receivable	78,412	72,192
Inventory	37,092	37,357
Deferred income taxes	21,094	23,014
Regulatory assets — revenue accruals, including accrued interest	6,310	7,489
Prepaid assets	18,367	29,235
Other	5,179	2,752
Total current assets	234,036	198,226
Property, plant and equipment (net of accumulated depreciation and amortization of $1,289,769 and $1,269,810, respectively)	4,317,746	4,134,579
Other assets		
Goodwill	950,163	950,163
Intangible assets (net of accumulated amortization of $19,188 and $18,397, respectively)	47,701	48,492
Regulatory assets — revenue accruals, including accrued interest	14,594	2,719
Other regulatory assets	181,797	180,378
Deferred financing fees (net of accumulated amortization of $18,742 and $17,838, respectively)	18,721	19,293
Other	30,729	30,959
Total other assets	1,243,705	1,232,004
TOTAL ASSETS	$5,795,487	$5,564,809
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$109,646	$123,022
Accrued payroll	10,174	20,740
Accrued interest	44,722	44,708
Accrued taxes	23,221	28,117
Regulatory liabilities — revenue deferrals, including accrued interest	47,736	53,763
Refundable deposits from generators for transmission network upgrades	30,083	40,745
Debt maturing within one year	901,962	651,929
Other	38,408	40,287
Total current liabilities	1,205,952	1,003,311
Accrued pension and postretirement liabilities	55,349	53,243
Deferred income taxes	484,577	460,072
Regulatory liabilities — revenue deferrals, including accrued interest	33,479	28,613
Regulatory liabilities — accrued asset removal costs	74,549	75,477
Refundable deposits from generators for transmission network upgrades	6,019	7,623
Other	23,088	26,317
Long-term debt	2,458,881	2,495,298
Commitments and contingent liabilities (Note 10)		
STOCKHOLDERS' EQUITY		

Common stock, without par value, 100,000,000 shares authorized, 52,317,093 and 52,248,514 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively	995,509	989,334
Retained earnings	474,026	443,569
Accumulated other comprehensive loss	(15,942)	(18,048)
Total stockholders' equity	1,453,593	1,414,855
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$5,795,487	$5,564,809

See notes to condensed consolidated financial statements (unaudited).

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ITC HOLDINGS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three months ended March 31,	
(in thousands, except per share data)	2013	2012
OPERATING REVENUES	$217,304	$196,713
OPERATING EXPENSES		
Operation and maintenance	24,513	28,712
General and administrative	34,926	23,009
Depreciation and amortization	28,486	25,011
Taxes other than income taxes	16,670	14,280
Other operating (income) and expense — net	(172)	(193)
Total operating expenses	104,423	90,819
OPERATING INCOME	112,881	105,894
OTHER EXPENSES (INCOME)		
Interest expense	39,063	37,910
Allowance for equity funds used during construction	(8,733)	(5,624)
Other income	(236)	(306)
Other expense	1,037	831
Total other expenses (income)	31,131	32,811
INCOME BEFORE INCOME TAXES	81,750	73,083
INCOME TAX PROVISION	31,560	27,032
NET INCOME	$50,190	$46,051
Basic earnings per common share	$0.96	$0.90
Diluted earnings per common share	$0.95	$0.88
Dividends declared per common share	$0.3775	$0.3525

See notes to condensed consolidated financial statements (unaudited).

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ITC HOLDINGS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three months ended March 31,	
(in thousands)	2013	2012
NET INCOME	$50,190	$46,051
OTHER COMPREHENSIVE INCOME		
Amortization of interest rate lock cash flow hedges (net of tax of $10 and $9, respectively)	14	15
Unrealized gain on interest rate swaps relating to interest rate cash flow hedges (net of tax of $1,365 and $1,803, respectively)	2,092	2,812
TOTAL OTHER COMPREHENSIVE INCOME, NET OF TAX	2,106	2,827
TOTAL COMPREHENSIVE INCOME	$52,296	$48,878

See notes to condensed consolidated financial statements (unaudited).

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ITC HOLDINGS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)	Three months ended March 31, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$50,190	$46,051
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	28,486	25,011
Recognition, refund and collection of revenue accruals and deferrals — including accrued interest	(11,857)	(16,779)
Deferred income tax expense	21,329	16,191
Allowance for equity funds used during construction	(8,733)	(5,624)
Other	3,992	2,974
Changes in assets and liabilities, exclusive of changes shown separately:		
Accounts receivable	(4,341)	1,232
Inventory	265	1,771
Prepaid and other current assets	10,857	(4,421)
Accounts payable	(5,193)	(4,840)
Accrued payroll	(7,040)	(6,726)
Accrued interest	14	(19,448)
Accrued taxes	(4,896)	(6,505)
Other current liabilities	(839)	(3,641)
Other non-current assets and liabilities, net	(266)	4,429
Net cash provided by operating activities	71,968	29,675
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(214,111)	(224,079)
Other	(103)	(50)
Net cash used in investing activities	(214,214)	(224,129)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	—	100,000
Borrowings under revolving credit agreements	369,500	342,250
Borrowings under term loan credit agreements	250,000	—
Repayments of revolving credit agreements	(406,000)	(268,500)
Issuance of common stock	2,632	1,050
Dividends on common and restricted stock	(19,733)	(18,101)
Refundable deposits from generators for transmission network upgrades	8,058	9,636
Repayment of refundable deposits from generators for transmission network upgrades	(20,325)	(5,661)
Other	(491)	(1,512)
Net cash provided by financing activities	183,641	159,162
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	41,395	(35,292)
CASH AND CASH EQUIVALENTS — Beginning of period	26,187	58,344
CASH AND CASH EQUIVALENTS — End of period	$67,582	$23,052

See notes to condensed consolidated financial statements (unaudited).

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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

	Three months ended March 31,	
(in thousands)	2013	2012
Supplementary cash flows information:		
Interest paid (net of interest capitalized)	$38,144	$56,262
Income taxes paid	1,100	9,324
Supplementary non-cash investing and financing activities:		
Additions to property, plant and equipment (a)	$79,933	$78,252
Allowance for equity funds used during construction	8,733	5,624

(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 March 31, 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 for 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 months ended March 31, 2013, the requirements under (1) above are presented in the condensed consolidated statements of comprehensive income, however, there were no significant amounts reclassified out of AOCI that would require disclosure.

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 March 31, 2013, we did not have any material assets and liabilities that are subject to the new disclosure requirements.

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3. REGULATORY MATTERS

ITC Great Plains

As of March 31, 2013, we have recorded a total of $14.1 million of regulatory assets for start-up and development expenses 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, ITC Great Plains will be required to make an additional filing with the FERC under Section 205 of the FPA in order to recover these start-up, development and pre-construction expenses in future rates. If FERC authorization to recover these costs is received, ITC Great Plains will include the 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. The MISO Regulated Operating Subsidiaries were named in the order. We do not expect the resolution of this proceeding and its ultimate impact on our MISO Regulated Operating Subsidiaries’ formula rates will be material to our results of operations, cash flows or financial condition.

Complaint of IP&L

On September 14, 2012, IP&L filed a complaint with the FERC against ITC Midwest’s reimbursement policy under Section 206 of the Federal Power Act. The complaint challenges ITC Midwest’s FERC approved reimbursement policy for network upgrades to qualifying generators. IP&L requests that the FERC (1) investigate the justness and reasonableness of ITC Midwest’s Attachment FF policy; (2) establish a refund effective date of September 14, 2012; and (3) establish hearing procedures. On October 4, 2012, ITC Midwest filed an answer to the complaint with the FERC outlining the reasons ITC Midwest’s Attachment FF provision remains just and reasonable and requesting dismissal of the complaint.

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.

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The current and non-current regulatory assets are recorded on the balance sheet in regulatory assets revenue accruals, including accrued interest. The current and non-current regulatory liabilities are recorded in regulatory liabilities revenue deferrals, including accrued interest. The changes in regulatory assets and liabilities (net) associated with our Regulated Operating Subsidiaries' formula rate revenue accruals and deferrals, including accrued interest, were as follows during the three months ended March 31, 2013:

(in thousands)	Total
Balance as of December 31, 2012	$(72,168)
Net refund of 2011 revenue deferrals and accruals, including accrued interest	11,766
Net revenue accrual for the three months ended March 31, 2013	687
Net accrued interest payable for the three months ended March 31, 2013	(596)
Balance as of March 31, 2013	$(60,311)

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

(in thousands)	Total
Current assets	$6,310
Non-current assets	14,594
Current liabilities	(47,736)
Non-current liabilities	(33,479)
Balance as of March 31, 2013	$(60,311)

4. INTANGIBLE ASSETS

We have recorded intangible assets as a result of the METC acquisition in 2006. The carrying value of these assets was $39.5 million (net of accumulated amortization of $18.9 million) as of March 31, 2013.

We have also recorded intangible assets for payments 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 $8.2 million (net of accumulated amortization of $0.3 million) as of March 31, 2013.

During the three months ended March 31, 2013 and 2012, we recognized $0.8 million of amortization expense of our intangible assets. For each of the next five years, we expect the annual amortization of our intangible assets that have been recorded as of March 31, 2013 to be $3.2 million per year.

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5. DEBT

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. The interest rate swaps listed below manage interest rate risk associated with the forecasted future issuances of fixed-rate debt related to (1) the expected refinancing of the $267.0 million ITC Holdings 5.25% Senior Notes, due July 15, 2013, prior to its maturity and (2) the expected financing required to repay the $200.0 million and $250.0 million borrowed under the existing ITC Holdings unsecured, unguaranteed term loan credit agreements, due August 23, 2013 and December 31, 2013, respectively, prior to their maturity:

Interest Rate Swaps	Notional Amount	Fixed Rate	Original Term	Effective Date
(amounts in millions)				
September 2010 swap	$50.0	3.60%	10 years	July 2013
March 2011 swaps	50.0	4.45%	10 years	July 2013
May 2011 swap	25.0	4.20%	10 years	July 2013
August 2011 swaps	50.0	3.80%	10 years	July 2013
November 2012 swap	25.0	2.60%	30 years	June 2013
December 2012 swap	25.0	2.58%	30 years	June 2013
February 2013 swap	25.0	2.98%	30 years	June 2013
February 2013 swap	25.0	2.93%	30 years	June 2013
Total	$275.0			

The 10 year term interest rate swaps call for ITC Holdings to receive interest quarterly at a variable rate equal to LIBOR and to pay interest semi-annually at various fixed rates effective for the 10-year period beginning July 15, 2013 after the agreements have been terminated. The agreements include a mandatory early termination provision and will be terminated no later than the effective date of the interest rate swaps of July 15, 2013. The 30 year term interest rate swaps call for ITC Holdings to receive interest quarterly at a variable rate equal to LIBOR and to pay interest semi-annually at various fixed rates effective for the 30-year period beginning June 15, 2013 after the agreements have been terminated. The agreements include a mandatory early termination provision and will be terminated no later than the effective date of the interest rate swaps of July 15, 2013 and June 15, 2013 for the 10- and 30-year swaps, respectively. The interest rate swaps have been determined to be highly effective at offsetting changes in the fair value of the forecasted interest cash flows associated with the expected debt issuance attributable to changes in benchmark interest rates from the trade date of the interest rate swaps to the issuance date of the debt obligation. In April 2013, we entered into additional interest rate swap contracts with terms that are comparable to the interest rate swaps described above, consisting of an additional $75.0 million notional amount of 10-year term interest rate swaps with a weighted average fixed rate of 3.37% and $125.0 million notional amount of 30-year term interest rate swaps with a weighted average fixed rate of 2.82%.

As of March 31, 2013, there has been no material ineffectiveness recorded in the condensed consolidated statement of operations. The interest rate swaps qualify for hedge accounting treatment, whereby any gain or loss recognized from the trade date to the effective date for the effective portion of the hedge is recorded net of tax in accumulated other comprehensive income. These amounts will be accumulated and amortized as a component of interest expense over the life of the forecasted debt. As of March 31, 2013, the fair value of the derivative instruments was an asset of $5.1 million recorded to other current assets and a liability of $30.5 million recorded to other current liabilities. None of the interest rate swaps contain credit-risk-related contingent features. Refer to Note 9 for additional fair value information.

ITC Holdings

On August 23, 2012, ITC Holdings entered into a new unsecured, unguaranteed term loan credit agreement (“2012 Term Loan”), under which ITC Holdings had borrowed $200.0 million as of March 31, 2013 and as of December 31, 2012. On February 15, 2013, ITC Holdings entered into a new unsecured, unguaranteed term loan credit agreement with a borrowing capacity of $250.0 million (“2013 Term Loan”), under which ITC Holdings borrowed $250.0 million as of March 31, 2013. The proceeds from each term loan were used for general corporate purposes, including the repayment of borrowings under the ITC Holdings' revolving credit agreement. The 2012 Term Loan and the 2013 Term Loan are scheduled to mature on August 23, 2013 and December 31, 2013, respectively. The weighted-average interest rate on the borrowings outstanding under the term loans was 1.2% at March 31, 2013.

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ITC Midwest

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

Revolving Credit Agreements

At March 31, 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	0.25 %	5 years	May 2016
ITCTransmission	100.0	2.5	97.5	1.4%	0.125 %	5 years	May 2016
METC	100.0	31.3	68.7	1.3%	0.125 %	5 years	May 2016
ITC Midwest	175.0	146.2	28.8	1.2%	0.10 %	5 years	May 2017
ITC Great Plains	150.0	111.3	38.7	2.0%	0.30 %	4 years	February 2015
Total	$725.0	$291.3	$433.7				

(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.

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

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, although 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.

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7. 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 months ended March 31, 2013 and 2012 is presented in the following table:

	Three months ended March 31,	
(in thousands, except share, per share data and percentages)	2013	2012
Numerator:		
Net income	$50,190	$46,051
Less: dividends declared — common shares and restricted shares	(19,733)	(18,101)
Undistributed earnings	30,457	27,950
Percentage allocated to common shares (a)	99.0 %	98.6 %
Undistributed earnings — common shares	30,152	27,559
Add: dividends declared — common shares	19,537	17,851
Numerator for basic and diluted earnings per common share	$49,689	$45,410
Denominator:		
Denominator for basic earnings per common share — weighted-average common shares	51,756,765	50,636,200
Incremental shares for stock options and employee stock purchase plan	378,406	768,834
Denominator for diluted earnings per common share — adjusted weighted-average shares and assumed conversion	52,135,171	51,405,034
Per common share net income:		
Basic	$0.96	$0.90
Diluted	$0.95	$0.88

(a) Weighted-average common shares outstanding	51,756,765	50,636,200
Weighted-average restricted shares (participating securities)	519,996	709,091
Total	52,276,761	51,345,291
Percentage allocated to common shares	99.0 %	98.6 %

The incremental shares for stock options and the employee stock purchase plan ("stock options and ESPP shares") 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 as of March 31, 2013 and 2012 and the anti-dilutive stock options and ESPP shares excluded from the diluted earnings per share calculations for the three months ended March 31, 2013 and 2012 were as follows:

	2013	2012
Outstanding stock options and ESPP shares	1,549,860	2,066,083
Anti-dilutive stock options and ESPP shares	356,730	214,993

8. 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 expect to contribute up to $6.9 million to the defined benefit retirement plan in 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 expect to contribute up to $0.6 million to these supplemental nonqualified, noncontributory, retirement benefit plans in 2013.

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Net pension cost includes the following components:

	Three months ended March 31,	
(in thousands)	2013	2012
Service cost	$1,315	$1,040
Interest cost	763	647
Expected return on plan assets	(717)	(570)
Amortization of prior service cost	(10)	(10)
Amortization of unrecognized loss	679	868
Net pension cost	$2,030	$1,975

Other Postretirement Benefits

We provide certain postretirement health care, dental, and life insurance benefits for employees who may become eligible for these benefits. We expect to contribute up to $3.8 million to the postretirement benefit plan in 2013.

Net postretirement cost includes the following components:

	Three months ended March 31,	
(in thousands)	2013	2012
Service cost	$1,443	$1,358
Interest cost	390	388
Expected return on plan assets	(353)	(254)
Amortization of prior service cost	—	31
Amortization of unrecognized loss	55	134
Net postretirement cost	$1,535	$1,657

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 $1.7 million and $1.3 million for the three months ended March 31, 2013 and 2012, respectively.

9. 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 and liabilities measured at fair value subject to the three-tier hierarchy at March 31, 2013, were as follows:

	Fair Value Measurements at Reporting Date Using		
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets measured on a recurring basis:			
Cash and cash equivalents — cash equivalents	$35,935	$30,243	$—
Mutual funds — fixed income securities	21,113	—	—
Mutual funds — equity securities	1,766	—	—
Interest rate swap derivatives	—	5,142	—
Financial liabilities measured on a recurring basis:			
Interest rate swap derivatives	—	(30,468)	—
Total	$58,814	$4,917	$—

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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		
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
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 March 31, 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 that are classified as trading securities. Our Level 1 investments included in 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 consist of interest rate swaps discussed in Note 5. The fair value of our interest rate swap derivatives as of March 31, 2013 and December 31, 2012 is determined based on a discounted cash flow method using LIBOR swap rates which are observable at commonly quoted intervals.

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 three months ended March 31, 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.

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 $3,034.8 million and $3,072.9 million at March 31, 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 $2,619.5 million and $2,619.4 million at March 31, 2013 and December 31, 2012, respectively.

Revolving and Term Loan Credit Agreements

At March 31, 2013 and December 31, 2012, we had a consolidated total of $741.3 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.

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10. 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 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.

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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 use tax liability associated with the exemptions taken by ITCTransmission through March 31, 2013 is estimated to be approximately $15.6 million, which includes approximately $3.7 million assessed for the audit period April 1, 2005 through June 30, 2008, including interest. 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 $11.0 million for periods still subject to audit since 2006. 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 Interstate Power and Light Company 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 expected to be refunded in 2014.

ITCTransmission and METC have 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, which includes the amount expected to be refunded in 2014.

As a result of the FERC order, ITC Midwest, ITCTransmission and METC have recorded an aggregate estimated liability for the refund and related interest of $12.8 million as of March 31, 2013 in the condensed consolidated statements of financial position. The refund amounts are limited to 2010 and earlier periods. The ITCTransmission and METC compliance plans and refund reports remain subject to FERC acceptance, however, we do not believe the ultimate resolution of this matter will differ materially from the estimates recorded during 2012.

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 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. The Minnesota Public Utilities Commission is monitoring the status of the project, and ITC Midwest is providing it with periodic status updates about the project and other information about transmission system conditions, as requested in a May 15, 2012 Order. We believe we used commercially reasonable best efforts to meet the December 31, 2011 deadline and will continue to pursue completion of the project using our commercially reasonable best efforts. Therefore, we believe the likelihood of any material effect from this matter is remote.

11. 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.

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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. 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 will result in shareholders of Entergy receiving approximately 50.1% of the shares of pro forma ITC Holdings in exchange for their shares of Mid South TransCo, with existing shareholders of ITC Holdings owning the remaining approximately 49.9% of the combined company. In addition, Entergy will receive gross cash proceeds of $1.775 billion from indebtedness that will be incurred by Mid South TransCo and its subsidiaries prior to the merger and assumed under the acquisition. On April 16, 2013, ITC Holdings received the necessary shareholder approvals to consummate the merger. Completion of the transaction is expected in 2013 subject to the satisfaction of certain closing conditions, including the receipt of necessary approvals of Entergy’s retail regulators and the FERC.

For the three months ended March 31, 2013 and 2012, we expensed external legal, advisory and financial services fees of $8.7 million and $2.4 million, respectively, and certain internal labor and related costs of approximately $2.3 million and $1.5 million, respectively, related to the Entergy Transaction recorded primarily within general and administrative expenses. The external and internal costs related to the Entergy Transaction are not included as components of revenue requirement at our Regulated Operating Subsidiaries as they were incurred at ITC Holdings.

Per 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.

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12. 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:

OPERATING REVENUES:	Three months ended March 31,	
(in thousands)	2013	2012
Regulated Operating Subsidiaries	$217,379	$196,733
ITC Holdings and other	152	152
Intercompany eliminations	(227)	(172)
Total Operating Revenues	$217,304	$196,713

INCOME BEFORE INCOME TAXES:	Three months ended March 31,	
(in thousands)	2013	2012
Regulated Operating Subsidiaries	$119,260	$100,924
ITC Holdings and other	(37,510)	(27,841)
Total Income Before Income Taxes	$81,750	$73,083

NET INCOME:	Three months ended March 31,	
(in thousands)	2013	2012
Regulated Operating Subsidiaries	$73,756	$62,475
ITC Holdings and other	50,190	46,051
Intercompany eliminations	(73,756)	(62,475)
Total Net Income	$50,190	$46,051

TOTAL ASSETS:	March 31,	December 31,
(in thousands)	2013	2012
Regulated Operating Subsidiaries	$5,536,371	$5,440,401