

ITC Holdings Corp.  
Form 10-K  
March 01, 2013  
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-K  
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2012

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

Commission File Number: 001-32576

ITC HOLDINGS CORP.

(Exact Name of Registrant as Specified in Its Charter)

Michigan

(State or Other Jurisdiction of  
Incorporation or Organization)

27175 Energy Way

Novi, Michigan 48377

(Address Of Principal Executive Offices, Including Zip Code)

(248) 946-3000

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Common stock, without par value

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information, statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Smaller Reporting Company

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

(Do not check if a smaller reporting  
company)

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

Yes  No

The aggregate market value of the registrant's common stock held by non-affiliates on June 30, 2012 was approximately \$3.5 billion, based on the closing sale price as reported on the New York Stock Exchange. For purposes of this computation, all executive officers, directors and 10% beneficial owners of the registrant are assumed to be affiliates. Such determination should not be deemed an admission that such officers, directors and beneficial owners are, in fact, affiliates of the registrant.

The number of shares of the Registrant's Common Stock, without par value, outstanding as of February 26, 2013 was 52,272,984.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive Proxy Statement for the Registrant's 2013 Annual Meeting of Shareholders (the "Proxy Statement") filed pursuant to Regulation 14A are incorporated by reference in Part III of this Form 10-K.

---

Table of Contents

ITC Holdings Corp.  
 Form 10-K for the Fiscal Year Ended December 31, 2012  
 INDEX

|   | Page           |
|---|----------------|
| <u>PART I</u>   | <u>5</u>       |
| <u>Item 1. Business</u>   | <u>5</u>       |
| <u>Item 1A. Risk Factors</u>  | <u>16</u>      |
| <u>Item 1B. Unresolved Staff Comments</u>   | <u>25</u>      |
| <u>Item 2. Properties</u>   | <u>25</u>      |
| <u>Item 3. Legal Proceedings</u>  | <u>26</u>      |
| <u>Item 4. Mine Safety Disclosures</u>  | <u>27</u>      |
| <br><u>PART II</u>  | <br><u>27</u>  |
| <u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>27</u>      |
| <u>Item 6. Selected Financial Data</u>  | <u>29</u>      |
| <u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | <u>30</u>      |
| <u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>  | <u>51</u>      |
| <u>Item 8. Financial Statements and Supplementary Data</u>  | <u>53</u>      |
| <u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | <u>98</u>      |
| <u>Item 9A. Controls and Procedures</u>   | <u>98</u>      |
| <u>Item 9B. Other Information</u>   | <u>99</u>      |
| <br><u>PART III</u>   | <br><u>99</u>  |
| <u>Item 10. Directors, Executive Officers and Corporate Governance</u>  | <u>99</u>      |
| <u>Item 11. Executive Compensation</u>  | <u>99</u>      |
| <u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | <u>100</u>     |
| <u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>                                   | <u>100</u>     |
| <u>Item 14. Principal Accountant Fees and Services</u>  | <u>100</u>     |
| <br><u>PART IV</u>  | <br><u>101</u> |
| <u>Item 15. Exhibits and Financial Statement Schedules</u>  | <u>101</u>     |
| <u>Signatures</u>   | <u>108</u>     |
| <u>Exhibits</u>   | <u>109</u>     |

Table of Contents

DEFINITIONS

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

ITC Holdings Corp. and its subsidiaries

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

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

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

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

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

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

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

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

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

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

Other definitions

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

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

“DTE Energy” are references to 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;

“ICC” are references to the Illinois Commerce Commission;

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

“ISO” are references to Independent System Operators;

“IUB” are references to the Iowa Utilities Board;

“KCC” are references to the Kansas Corporation Commission;

“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 ITC Transmission, METC and ITC Midwest are members;

Table of Contents

•“MOPSC” are references to the Missouri Public Service Commission;  
•“MPSC” are references to the Michigan Public Service Commission;  
•“MPUC” are references to the Minnesota Public Utilities Commission;  
•“MW” are references to megawatts (one megawatt equaling 1,000,000 watts);  
•“NERC” are references to the North American Electric Reliability Corporation;  
•“NOLs” are references to net operating loss carryforwards for income taxes;  
•“OCC” are references to Oklahoma Corporation Commission;  
•“RTO” are references to Regional Transmission Organizations; and  
•“SPP” are references to Southwest Power Pool, Inc., a FERC-approved RTO which oversees the operation of the bulk power transmission system for a substantial portion of the South Central United States, and of which ITC Great Plains is a member.

Table of Contents

PART I

ITEM 1. BUSINESS.

Overview

Our business consists primarily of the electric transmission operations of our Regulated Operating Subsidiaries. In 2002, ITC Holdings was incorporated in the State of Michigan for the purpose of acquiring ITCTransmission. ITCTransmission was originally formed in 2001 as a subsidiary of Detroit Edison, an electric utility subsidiary of DTE Energy, and was acquired in 2003 by ITC Holdings. METC was originally formed in 2001 as a subsidiary of Consumers Energy, an electric and gas utility subsidiary of CMS Energy Corporation, and was acquired in 2006 by ITC Holdings. ITC Midwest was formed in 2007 by ITC Holdings to acquire the transmission assets of IP&L in December 2007. ITC Great Plains was formed in 2006 by ITC Holdings and became a FERC-jurisdictional entity in 2009 after acquiring certain electric transmission assets in Kansas. We operate high-voltage systems in Michigan's Lower Peninsula and portions of Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma that transmit electricity from generating stations to local distribution facilities connected to our systems.

Our business strategy is to operate, maintain and invest in transmission infrastructure in order to enhance system integrity and reliability, to reduce transmission constraints and to allow new generating resources to interconnect to our transmission systems. We also are pursuing development projects not within our existing systems, which are also intended to improve overall grid reliability, reduce transmission constraints and facilitate interconnections of new generating resources, as well as to enhance competitive wholesale electricity markets.

As electric transmission utilities with rates regulated by the FERC, our Regulated Operating Subsidiaries earn revenues through tariff rates charged for the use of their electric transmission systems by our customers, which include investor-owned utilities, municipalities, cooperatives, power marketers and alternative energy suppliers. As independent transmission companies, our Regulated Operating Subsidiaries are subject to rate regulation only by the FERC. The rates charged by our Regulated Operating Subsidiaries are established using cost-based formula rate templates as discussed in "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism."

Development of Business

We are actively developing transmission infrastructure required to meet reliability needs and emerging long-term energy policy. Our long-term growth plan includes continued investment in current transmission systems, generator interconnections, and our ongoing development projects. Refer to "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations — Capital Investment and Operating Results Trends" for additional details about our long-term capital investment program totaling \$4.2 billion for the period 2012 through 2016. In addition, we have entered into definitive agreements whereby the electric transmission business of Entergy will be separated and subsequently merged with a wholly-owned subsidiary of ITC Holdings as discussed under "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations—Capital Project Updates and Other Recent Developments." Finally, refer to the discussion of risks associated with our strategic development opportunities in "Item 1A Risk Factors — Our Regulated Operating Subsidiaries' actual capital expenditures may be lower than planned, which would decrease expected rate base and therefore our expected revenues and earnings. In addition, we expect to invest in strategic development opportunities to improve the efficiency and reliability of the transmission grid, but we cannot assure you that we will be able to initiate or complete any of these investments."

Current Transmission Systems

We expect to invest approximately \$1.6 billion from 2012 through 2016 at our Regulated Operating Subsidiaries in order to maintain and replace the current transmission infrastructure, enhance system integrity and reliability and accommodate load growth.

Network Upgrades to Support Generator Interconnections

We expect to invest approximately \$0.9 billion from 2012 through 2016 to develop and build transmission infrastructure to support generator interconnections.

In 2010, we received MISO approval of the Thumb Loop Project which is primarily located in ITCTransmission's region. The Thumb Loop Project is a 140-mile, double-circuit 345 kV transmission line and related substations that



## Table of Contents

will serve as the backbone of the transmission system needed to accommodate future wind development projects in the Michigan counties of Tuscola, Huron, Sanilac and St. Clair.

Based on the anticipated growth of generating resources, we also foresee the need to construct additional transmission facilities that will provide interconnection opportunities for generating facilities. The backbone transmission network, transmission for wind interconnection and transmission for interconnection of other generating facilities may provide additional investment opportunities.

### Development Projects

We expect to invest approximately \$1.7 billion from 2012 through 2016 to construct our portions of various development projects that we are currently advancing in the South Central and North Central regions of the country. We are pursuing strategic development opportunities for transmission investments related to upgrading the existing transmission grid and regional transmission facilities, primarily to improve overall grid reliability, reduce transmission constraints, enhance competitive markets and facilitate interconnections of new generating resources, including wind generation and other renewable resources.

### South Central Region

We have pursued the opportunity to invest in certain transmission projects in Kansas and Oklahoma, through ITC Great Plains. Two of these projects, the KETA Project consisting of a transmission line that runs between Spearville, Kansas and Axtell, Nebraska, and the Hugo to Valliant Project in Oklahoma, were completed and placed in-service in 2012.

A third project, known as the Kansas V-Plan Project, which consists of a transmission line running from the Spearville substation to Medicine Lodge, Kansas, is currently under construction.

### North Central Region

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

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

### Segments

We have one reportable segment consisting of our Regulated Operating Subsidiaries. Additionally, we have other subsidiaries focused primarily on business development activities and a holding company whose activities include corporate debt and equity financings and general corporate activities. A more detailed discussion of our reportable segment, including financial information about the segment, is included in Note 18 to the consolidated financial statements.

### Operations

As transmission-only companies, our Regulated Operating Subsidiaries function as conduits, allowing for power from generators to be transmitted to local distribution systems either entirely through their own systems or in conjunction with neighboring transmission systems. Third parties then transmit power through these local distribution systems to end-use consumers. The transmission of electricity by our Regulated Operating Subsidiaries is a central function to the provision of electricity to residential, commercial and industrial end-use consumers. The operations performed by our Regulated Operating Subsidiaries fall into the following categories:

- asset planning;
- engineering, design and construction;





## Table of Contents

maintenance; and  
real time operations.

### Asset Planning

Our Asset Planning group uses detailed system models and long-term load forecasts to develop our system expansion capital plans. The expansion plans identify projects that would address potential future reliability issues and/or produce economic savings for customers by eliminating constraints.

Asset Planning works closely with MISO and SPP in the development of our system expansion capital plans by performing technical evaluations and detailed studies. As the regional planning authorities, MISO and SPP approve regional system improvement plans which include projects to be constructed by their members, including our Regulated Operating Subsidiaries.

### Engineering, Design and Construction

Our Engineering, Design and Construction group is responsible for design, equipment specifications, maintenance plans and project engineering for capital, operation and maintenance work. We work with outside contractors to perform some of our engineering and design and all of our construction, but retain internal technical experts who have experience with respect to the key elements of the transmission system such as substations, lines, equipment and protective relaying systems.

### Maintenance

We develop and track preventive maintenance plans to promote safe and reliable systems. By performing preventive maintenance on our assets, we can minimize the need for reactive maintenance, resulting in improved reliability. Our Regulated Operating Subsidiaries contract with Utility Lines Construction Services, Inc. (“ULCS”), which is a division of Asplundh Tree Expert Co., to perform the majority of their maintenance. The agreement with ULCS provides us with access to an experienced and scalable workforce with knowledge of our system at an established rate.

### Real Time Operations

System Operations. From our operations facility in Novi, Michigan, transmission system operators continuously monitor the performance of the transmission systems of our Regulated Operating Subsidiaries, using software and communication systems to perform analysis to plan for contingencies and maintain security and reliability following any unplanned events on the system. Transmission system operators are also responsible for the switching and protective tagging function, taking equipment in and out of service to ensure capital construction projects and maintenance programs can be completed safely and reliably.

Local Balancing Authority Operator. Under the functional control of MISO, ITCTransmission and METC operate their electric transmission systems as a combined Local Balancing Authority (“LBA”) area, known as the Michigan Electric Coordinated Systems (“MECS”). From our operations facility in Novi, Michigan, our employees perform the LBA functions as outlined in MISO’s Balancing Authority Agreement. These functions include actual interchange data administration and verification and MECS LBA area emergency procedure implementation and coordination. ITC Midwest and ITC Great Plains are not responsible for LBA functions for their respective assets.

### Operating Contracts

Our Regulated Operating Subsidiaries have various operating contracts, including numerous interconnection agreements with generation and transmission providers that address terms and conditions of interconnection. The following significant agreements exist at our Regulated Operating Subsidiaries:

#### ITCTransmission

Detroit Edison operates the electric distribution system to which ITCTransmission’s transmission system connects. A set of three operating contracts sets forth the terms and conditions related to Detroit Edison’s and ITCTransmission’s ongoing working relationship. These contracts include the following:

Master Operating Agreement. The Master Operating Agreement (the “MOA”), dated as of February 28, 2003, governs the primary day-to-day operational responsibilities of ITCTransmission and Detroit Edison and will remain in effect until terminated by mutual agreement of the parties (subject to any required FERC approvals) unless earlier terminated pursuant to its terms. The MOA identifies the control area coordination services that



## Table of Contents

ITCTransmission is obligated to provide to Detroit Edison. The MOA also requires Detroit Edison to provide certain generation-based support services to ITCTransmission.

Generator Interconnection and Operation Agreement. Detroit Edison and ITCTransmission entered into the Generator Interconnection and Operation Agreement (the "GIOA"), dated as of February 28, 2003, in order to establish, re-establish and maintain the direct electricity interconnection of Detroit Edison's electricity generating assets with ITCTransmission's transmission system for the purposes of transmitting electric power from and to the electricity generating facilities. Unless otherwise terminated by mutual agreement of the parties (subject to any required FERC approvals), the GIOA will remain in effect until Detroit Edison elects to terminate the agreement with respect to a particular unit or until a particular unit ceases commercial operation.

Coordination and Interconnection Agreement. The Coordination and Interconnection Agreement (the "CIA"), dated as of February 28, 2003, governs the rights, obligations and responsibilities of ITCTransmission and Detroit Edison regarding, among other things, the operation and interconnection of Detroit Edison's distribution system and ITCTransmission's transmission system, and the construction of new facilities or modification of existing facilities. Additionally, the CIA allocates costs for operation of supervisory, communications and metering equipment. The CIA will remain in effect until terminated by mutual agreement of the parties (subject to any required FERC approvals).

### METC

Consumers Energy operates the electric distribution system to which METC's transmission system connects. METC is a party to a number of operating contracts with Consumers Energy that govern the operations and maintenance of its transmission system. These contracts include the following:

Amended and Restated Easement Agreement. Under the Amended and Restated Easement Agreement (the "Easement Agreement"), dated as of April 29, 2002 and as further supplemented, Consumers Energy provides METC with an easement to the land, which we refer to as premises, on which a majority of METC's transmission towers, poles, lines and other transmission facilities used to transmit electricity at voltages of at least 120 kV are located, which we refer to collectively as the facilities. Consumers Energy retained for itself the rights to, and the value of activities associated with, all other uses of the premises and the facilities covered by the Easement Agreement, such as for distribution of electricity, fiber optics, telecommunications, gas pipelines and agricultural uses. Accordingly, METC is not permitted to use the premises or the facilities covered by the Easement Agreement for any purposes other than to provide electric transmission and related services, to inspect, maintain, repair, replace and remove electric transmission facilities and to alter, improve, relocate and construct additional electric transmission facilities. The easement is further subject to the rights of any third parties that had rights to use or occupy the premises or the facilities prior to April 1, 2001 in a manner not inconsistent with METC's permitted uses.

METC pays Consumers Energy annual rent of \$10.0 million, in equal quarterly installments, for the easement and related rights under the Easement Agreement. Although METC and Consumers Energy share the use of the premises and the facilities covered by the Easement Agreement, METC pays the entire amount of any rentals, property taxes, inspection fees and other amounts required to be paid to third parties with respect to any use, occupancy, operations or other activities on the premises or the facilities and is generally responsible for the maintenance of the premises and the facilities used for electric transmission at its expense. METC also must maintain commercial general liability insurance protecting METC and Consumers Energy against claims for personal injury, death or property damage occurring on the premises or the facilities and pay for all insurance premiums. METC is also responsible for patrolling the premises and the facilities by air at its expense at least annually and to notify Consumers Energy of any unauthorized uses or encroachments discovered. METC must indemnify Consumers Energy for all liabilities arising from the facilities covered by the Easement Agreement.

METC must notify Consumers Energy before altering, improving, relocating or constructing additional transmission facilities covered by the Easement Agreement. Consumers Energy may respond by notifying METC of reasonable work and design restrictions and precautions that are needed to avoid endangering existing distribution facilities, pipelines or communications lines, in which case METC must comply with these restrictions and precautions. METC has the right at its own expense to require Consumers Energy to remove and relocate these facilities, but Consumers Energy may require payment in advance or the provision of reasonable security for payment by METC prior to removing or relocating these facilities, and Consumers Energy need not commence



Table of Contents

any relocation work until an alternative right-of-way satisfactory to Consumers Energy is obtained at METC's expense.

The term of the Easement Agreement runs through December 31, 2050 and is subject to 10 automatic 50-year renewals after that time unless METC provides one year's notice of its election not to renew the term. Consumers Energy may terminate the Easement Agreement 30 days after giving notice of a failure by METC to pay its quarterly installment if METC does not cure the non-payment within the 30-day notice period. At the end of the term or upon any earlier termination of the Easement Agreement, the easement and related rights terminate and the transmission facilities revert to Consumers Energy.

**Amended and Restated Operating Agreement.** Under the Amended and Restated Operating Agreement (the "Operating Agreement"), dated as of April 29, 2002, METC agrees to operate its transmission system to provide all transmission customers with safe, efficient, reliable and nondiscriminatory transmission service pursuant to its tariff. Among other things, METC is responsible under the Operating Agreement for maintaining and operating its transmission system, providing Consumers Energy with information and access to its transmission system and related books and records, administering and performing the duties of control area operator (that is, the entity exercising operational control over the transmission system) and, if requested by Consumers Energy, building connection facilities necessary to permit interaction with new distribution facilities built by Consumers Energy. Consumers Energy has corresponding obligations to provide METC with access to its books and records and to build distribution facilities necessary to provide adequate and reliable transmission services to wholesale customers. Consumers Energy must cooperate with METC as METC performs its duties as control area operator, including by providing reactive supply and voltage control from generation sources or other ancillary services and reducing load. The Operating Agreement is effective through 2050 and is subject to 10 automatic 50-year renewals after that time, unless METC provides one year's notice of its election not to renew.

**Amended and Restated Purchase and Sale Agreement for Ancillary Services.** The Amended and Restated Purchase and Sale Agreement for Ancillary Services (the "Ancillary Services Agreement") is dated as of April 29, 2002. Since METC does not own any generating facilities, it must procure ancillary services from third party suppliers, such as Consumers Energy. Currently, under the Ancillary Services Agreement, METC pays Consumers Energy for providing certain generation based services necessary to support the reliable operation of the bulk power grid, such as voltage support and generation capability and capacity to balance loads and generation. METC is not precluded from procuring these ancillary services from third party suppliers when available. The Ancillary Services Agreement is subject to rolling one-year renewals starting May 1, 2003, unless terminated by either METC or Consumers Energy with six months prior written notice.

**Amended and Restated Distribution-Transmission Interconnection Agreement.** The Amended and Restated Distribution-Transmission Interconnection Agreement (the "DT Interconnection Agreement"), dated April 1, 2001 and amended and restated most recently as of June 1, 2012, provides for the interconnection of Consumers Energy's distribution system with METC's transmission system and defines the continuing rights, responsibilities and obligations of the parties with respect to the use of certain of their own and the other party's properties, assets and facilities. METC agrees to provide Consumers Energy interconnection service at agreed-upon interconnection points, and the parties have mutual responsibility for maintaining voltage and compensating for reactive power losses resulting from their respective services. The DT Interconnection Agreement is effective so long as any interconnection point is connected to METC, unless it is terminated earlier by mutual agreement of METC and Consumers Energy.

**Amended and Restated Generator Interconnection Agreement.** The Amended and Restated Generator Interconnection Agreement (the "Generator Interconnection Agreement"), dated as of April 29, 2002 and amended most recently effective as of December 1, 2012, specifies the terms and conditions under which Consumers Energy and METC maintain the interconnection of Consumers Energy's generation resources and METC's transmission assets. The Generator Interconnection Agreement is effective either until it is replaced by any MISO-required contract, or until mutually agreed by METC and Consumers Energy to terminate, but not later than the date that all listed generators cease commercial operation.



## Table of Contents

### ITC Midwest

IP&L operates the electric distribution system to which ITC Midwest's transmission system connects. ITC Midwest is a party to a number of operating contracts with IP&L that govern the operations and maintenance of its transmission system. These contracts include the following:

**Distribution-Transmission Interconnection Agreement.** The Distribution-Transmission Interconnection Agreement (the "DTIA"), dated as of December 17, 2007, governs the rights, responsibilities and obligations of ITC Midwest and IP&L, with respect to the use of certain of their own and the other parties' property, assets and facilities, and the construction of new facilities or modification of existing facilities. Additionally, the DTIA sets forth the terms pursuant to which the equipment and facilities and the interconnection equipment of IP&L will continue to connect ITC Midwest's facilities through which ITC Midwest provides transmission service under the MISO Transmission and Energy Markets Tariff. The DTIA will remain in effect until terminated by mutual agreement by the parties (subject to any required FERC approvals) or as long as any interconnection point of IP&L is connected to ITC Midwest's facilities, unless modified by written agreement of the parties.

**Large Generator Interconnection Agreement.** ITC Midwest, IP&L and MISO entered into the Large Generator Interconnection Agreement (the "LGIA"), dated as of December 20, 2007, in order to establish, re-establish and maintain the direct electricity interconnection of IP&L's electricity generating assets with ITC Midwest's transmission system for the purposes of transmitting electric power from and to the electricity generating facilities. The LGIA will remain in effect until terminated by ITC Midwest or until IP&L elects to terminate the agreement if a particular unit ceases commercial operation for three consecutive years.

**Operations Services Agreement For 34.5 kV Transmission Facilities.** ITC Midwest and IP&L entered into the Operations Services Agreement for 34.5 kV Transmission Facilities (the "OSA"), effective as of January 1, 2011, under which IP&L performs certain operations functions for ITC Midwest's 34.5 kV transmission system on behalf of ITC Midwest. The OSA provides that when ITC Midwest upgrades 34.5 kV facilities to higher operating voltages it may notify IP&L of the change and the OSA is no longer applicable to those facilities. The OSA will remain in full force and effect until December 31, 2015 and will extend automatically from year to year thereafter until terminated by either party upon not less than one year prior written notice to the other party.

### ITC Great Plains

**Amended and Restated Maintenance Agreement.** Mid-Kansas Electric Company LLC ("Mid-Kansas") and ITC Great Plains have entered into a Maintenance Agreement (the "Mid-Kansas Agreement"), dated as of August 24, 2010, pursuant to which Mid-Kansas has agreed to perform various field operations and maintenance services related to the ITC Great Plains Elm Creek and Flat Ridge Substations, which ITC Great Plains purchased from Mid-Kansas. The Mid-Kansas Agreement has an initial term of 10 years and automatic 10-year renewals unless terminated (1) due to a breach by the non-terminating party following notice and failure to cure, (2) by mutual consent of the parties, or (3) by ITC Great Plains under certain limited circumstances. Services must continue to be provided for at least six months subsequent to the termination date in any case.

**Maintenance Agreement.** Midwest Energy, Inc. ("Midwest Energy") and ITC Great Plains have entered into a maintenance agreement (the "Midwest Energy Agreement") dated as of June 25, 2012. Pursuant to which Midwest Energy has agreed to perform various field operations and maintenance service related to ITC Great Plains facilities associated with the KETA project. The Midwest Energy Agreement has an initial term of three years with automatic three-year renewals unless terminated (1) due to a material breach by the non-terminating party following notice and failure to cure or (2) by mutual consent of the parties. Services must continue to be provided for at least six months subsequent to the termination date in any case.

### Regulatory Environment

Many regulators and public policy makers support the need for further investment in the transmission grid. The growth in electricity generation, wholesale power sales and consumption combined with historically inadequate transmission investment have resulted in significant transmission constraints across the United States and increased stress on aging equipment. These problems will continue without increased investment in transmission infrastructure. Transmission system investments can also increase system reliability and reduce the frequency of power outages. Such investments can reduce transmission constraints and improve access to lower cost generation resources, resulting



in a lower overall cost of delivered electricity for end-use consumers. After the 2003 blackout that affected sections of the Northeastern and Midwestern United States and Ontario, Canada, the Department of

Table of Contents

Energy (the “DOE”) established the Office of Electric Transmission and Distribution, focused on working with reliability experts from the power industry, state governments, and their Canadian counterparts to improve grid reliability and increase investment in the country’s electric infrastructure. In addition, the FERC has signaled its desire for substantial new investment in the transmission sector by implementing various financial and other incentives. The FERC has also issued orders to promote non-discriminatory transmission access for all transmission customers. In the United States, electric transmission assets are predominantly owned, operated and maintained by utilities that also own electricity generation and distribution assets, known as vertically integrated utilities. The FERC has recognized that the vertically-integrated utility model inhibits the provision of non-discriminatory transmission access and, in order to alleviate this potential discrimination, the FERC has mandated that all transmission systems over which it has jurisdiction must be operated in a comparable, non-discriminatory manner such that any seller of electricity affiliated with a transmission owner or operator is not provided with preferential treatment. The FERC has also indicated that independent transmission companies can play a prominent role in furthering its policy goals and has encouraged the legal and functional separation of transmission operations from generation and distribution operations.

On August 8, 2005, the Energy Policy Act was enacted, which requires the FERC to implement mandatory electric transmission reliability standards to be enforced by an Electric Reliability Organization. Effective June 2007, the FERC approved mandatory adoption of certain reliability standards and approved enforcement actions for violators, including fines of up to \$1.0 million per day. The NERC was assigned the responsibility of developing and enforcing these mandatory reliability standards. We continually assess our transmission systems against standards established by the NERC, as well as the standards of applicable regional entities under the NERC that have been delegated certain authority for the purpose of proposing and enforcing reliability standards. Finally, the Energy Policy Act repealed the Public Utility Holding Company Act of 1935, which was replaced by the Public Utility Holding Company Act of 2005. It also subjected utility holding companies to regulations of the FERC related to access to books and records, and amended Section 203 of the FPA to provide explicit authority for the FERC to review mergers and consolidations involving utility holding companies in certain circumstances.

**Federal Regulation**

As electric transmission companies, our Regulated Operating Subsidiaries are regulated by the FERC. The FERC is an independent regulatory commission within the DOE that regulates the interstate transmission and certain wholesale sales of natural gas, the transmission of oil and oil products by pipeline, and the transmission and wholesale sale of electricity in interstate commerce. The FERC also administers accounting and financial reporting regulations and standards of conduct for the companies it regulates. In 1996, in order to facilitate open access transmission for participants in wholesale power markets, the FERC issued Order No. 888. The open access policy promulgated by the FERC in Order No. 888 was upheld in a United States Supreme Court decision *State of New York vs. FERC*, issued on March 4, 2002. To facilitate open access, among other things, FERC Order No. 888 encouraged investor owned utilities to cede operational control over their transmission systems to ISOs, which are not-for-profit entities.

As an alternative to ceding operating control of their transmission assets to ISOs, certain investor owned utilities began to promote the formation of for-profit transmission companies, which would assume control of the operation of the grid. In December 1999, the FERC issued Order No. 2000, which strongly encouraged utilities to voluntarily transfer operational control of their transmission systems to RTOs. RTOs, as envisioned in Order No. 2000, would assume many of the functions of an ISO, but the FERC permitted greater flexibility with regard to the organization and structure of RTOs than it had for ISOs. RTOs could accommodate the inclusion of independently owned, for-profit companies that own transmission assets within their operating structure. Independent ownership would facilitate not only the independent operation of the transmission systems but also the formation of companies with a greater financial interest in maintaining and augmenting the capacity and reliability of those systems. RTOs such as MISO and SPP monitor electric reliability and are responsible for coordinating the operation of the wholesale electric transmission system and ensuring fair, non-discriminatory access to the transmission grid.

In July 2011, the FERC issued Order No. 1000 (“Order 1000”) which amends certain existing transmission planning and cost allocation requirements to ensure that FERC-jurisdictional services are provided at just and reasonable rates and on a basis that is just and reasonable and not unduly discriminatory or preferential. With respect to transmission planning, Order 1000: (1) requires that each public utility transmission provider participate in a regional transmission

planning process that produces a regional transmission plan; (2) requires that each

## Table of Contents

public utility transmission provider amend its Open Access Transmission Tariff (“OATT”) to describe procedures that provide for the consideration of transmission needs driven by public policy requirements in the local and regional transmission planning processes; (3) removes from FERC-approved tariffs and agreements a federal right of first refusal (“ROFR”) for certain new transmission facilities; and (4) improves coordination between neighboring transmission planning regions for new interregional transmission facilities. Order 1000 could potentially lead to greater competition for certain future transmission projects, including within our current operating area. Both MISO and SPP made compliance filings in the last quarter of 2012 to implement the first three requirements of Order 1000 noted above.

### Revenue Requirement Calculations and Cost Sharing for Projects with Regional Benefits

The cost based formula rates used by our Regulated Operating Subsidiaries continue to evolve to include revenue requirement calculations for various types of projects. Network revenues continue to be the largest component of revenues recovered through our formula rates. However, regional cost sharing revenues are growing as a result of projects that have been identified by MISO or SPP as having regional benefits, and therefore eligible for regional cost recovery under their tariff. Separate calculations of revenue requirement are performed for projects that have been approved for regional cost sharing and these separate calculations impact only which parties ultimately pay for the transmission services related to these projects and do not impact our financial results.

We have projects that are eligible for regional cost sharing under Attachment FF of the MISO tariff, such as certain network upgrade projects, and the MVPs, including the Thumb Loop Project. The FERC accepted MISO’s Thumb Loop Project MVP filing in 2010. Additionally, certain projects at ITC Great Plains are eligible for recovery through a region-wide charge in the SPP tariff: the KETA Project, which was part of the balanced portfolio of projects approved by SPP in 2009 and the Kansas V-Plan Project, which is subject to SPP’s highway/byway cost allocation. The FERC approved SPP’s highway/byway cost allocation methodology in 2010. These projects are described in more detail in “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Capital Project Updates and Other Recent Developments.”

### State Regulation

The regulatory agencies in the states where our Regulated Operating Subsidiaries’ assets are located do not have jurisdiction over rates or terms and conditions of service. However, they typically have jurisdiction over siting of transmission facilities and related matters as described below. Additionally, we are subject to the regulatory oversight of various state environmental quality departments for compliance with any state environmental standards and regulations.

#### ITC Transmission and METC

##### Michigan

The MPSC has jurisdiction over the siting of transmission facilities. Additionally, pursuant to Michigan Public Acts 197 and 198 of 2004, ITC Transmission and METC have the right as independent transmission companies to condemn property in the state of Michigan for the purposes of building or maintaining transmission facilities.

ITC Transmission and METC are also subject to the regulatory oversight of the Michigan Department of Environmental Quality, the Michigan Department of Natural Resources and certain local authorities for compliance with all environmental standards and regulations.

##### ITC Midwest

##### Iowa

Iowa Code ch. 478 provides that the IUB has the power of supervision over the construction, operation, and maintenance of transmission facilities in Iowa by any entity, which includes the power to issue franchises. Iowa Code ch. 478 further provides that any entity granted a franchise by the IUB is vested with the power of condemnation in Iowa to the extent the IUB approves and deems necessary for public use. A city has the power, pursuant to Iowa Code ch. 364, to grant a franchise to erect, maintain and operate transmission facilities within the city, which franchise may regulate the conditions required and manner of use of the streets and public grounds of the city and may confer the power to appropriate and condemn private property.



## Table of Contents

ITC Midwest also is subject to the regulatory oversight of certain state agencies (including the Iowa Department of Natural Resources) and certain local authorities with respect to the issuance of environmental, highway, railroad, and similar permits.

### Minnesota

The MPUC has jurisdiction over the construction, siting and routing of new transmission lines or upgrades of existing lines through Minnesota's Certificate of Need and Route Permit Processes. Transmission companies are also required to participate in the State's Biennial Transmission Planning Process and are subject to the state's preventative maintenance requirements. Pursuant to Minnesota law, ITC Midwest has the right as an independent transmission company to condemn property in the State of Minnesota for the purpose of building new transmission facilities. ITC Midwest is also subject to the regulatory oversight of the Minnesota Pollution Control Agency, the Minnesota Department of Natural Resources, the MPUC in conjunction with the Department of Commerce, and certain local authorities for compliance with applicable environmental standards and regulations.

### Illinois

The ICC exercises jurisdiction over siting of new transmission lines through its requirements for Certificates of Public Convenience and Necessity and Right-Of-Way acquisition that apply to construction of new or upgraded facilities. ITC Midwest also is subject to the regulatory oversight of the Illinois Environmental Protection Agency, the Illinois Department of Natural Resources, the Illinois Pollution Control Board and certain local authorities for compliance with all environmental standards and regulations.

### Missouri

Because ITC Midwest is a "public utility" and an "electrical corporation" under Missouri law, the MOPSC has jurisdiction to determine whether ITC Midwest may operate in such capacity. The MOPSC also exercises jurisdiction with regard to other non-rate matters affecting this Missouri asset such as transmission substation construction, general safety and the transfer of the franchise or property.

ITC Midwest is also subject to the regulatory oversight of the Missouri Department of Natural Resources for compliance with all environmental standards and regulations relating to this transmission line.

### ITC Great Plains

#### Kansas

ITC Great Plains is a "public utility" in Kansas and an "electric utility" pursuant to state statutes. The KCC issued an order approving the issuance of a limited certificate of convenience to ITC Great Plains for the purposes of building, owning and operating SPP transmission projects in Kansas. In addition to its certificate of authority, the KCC has jurisdiction over the siting of electric transmission lines.

ITC Great Plains is also subject to the regulatory oversight of the Kansas Department of Health and Environment for compliance with all environmental standards and regulations relating to the construction phase of any transmission line.

#### Oklahoma

ITC Great Plains has approval from the OCC to operate in Oklahoma, pursuant to Oklahoma Statutes as an electric public utility providing only transmission services. The OCC does not exercise jurisdiction over the siting of any transmission lines.

ITC Great Plains may be subject to the regulatory oversight of Oklahoma Department of Environmental Quality for compliance with environmental standards and regulations relating to construction of proposed transmission lines.

### Sources of Revenue

See "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Operating Revenues" for a discussion of our principal sources of revenue.

## Table of Contents

### Seasonality

The cost-based formula rates with a true-up mechanism in effect for all our Regulated Operating Subsidiaries, as discussed in “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism,” mitigate the seasonality of net income for our Regulated Operating Subsidiaries. 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. For example, to the extent that amounts billed are less than our revenue requirement for a reporting period, a revenue accrual is recorded for the difference and the difference results in no net income impact.

Operating cash flows are seasonal at our MISO Regulated Operating Subsidiaries, in that cash received for revenues is typically higher in the summer months when peak load is higher.

### Principal Customers

Our principal transmission service customers are Detroit Edison, Consumers Energy and IP&L, which accounted for approximately 26.7%, 25.6% and 27.0%, respectively, of our total operating revenues for the year ended December 31, 2012. One or more of these customers together have consistently represented a significant percentage of our operating revenue. These percentages of total operating revenues of Detroit Edison, Consumers Energy and IP&L include an estimate for the 2012 revenue accruals and deferrals that were included in our 2012 operating revenues, but will not be billed to our customers until 2014. We have assumed that the revenues billed to these customers in 2014 would be in the same proportion of the respective percentages of network and regional cost sharing revenues billed to them in 2012. Our remaining revenues were generated from providing service to other entities such as alternative electricity suppliers, power marketers and other wholesale customers that provide electricity to end-use consumers and from transaction-based capacity reservations. Nearly all of our revenues are from transmission customers in the United States. Although we may recognize allocated revenues from time to time from Canadian entities reserving transmission over the Ontario or Manitoba interface, these revenues have not been and are not expected to be material to us.

### Billing

MISO is responsible for billing and collection for transmission services and administers the transmission tariff in the MISO service territory. As the billing agent for our MISO Regulated Operating Subsidiaries, MISO bills Detroit Edison, Consumers Energy, IP&L and other customers on a monthly basis and collects fees for the use of our transmission systems.

SPP is responsible for billing and collection for transmission services and administers the transmission tariff in the SPP service territory of which ITC Great Plains is a member. As the billing agent for ITC Great Plains, SPP independently administers the transmission tariff.

See “Item 7A Quantitative and Qualitative Disclosures about Market Risk — Credit Risk” for discussion of our credit policies.

### Competition

Each of our MISO Regulated Operating Subsidiaries is the only transmission system in its respective service area and, therefore, effectively has no competitors. However, the competitive environment may change due to the implementation of Order 1000. See further discussion of Order 1000 above under “Regulatory Environment — Federal Regulation.” For our subsidiaries focused on development opportunities for transmission investment in other service areas, the incumbent utilities or other entities with transmission development initiatives may compete with us by seeking regulatory approval to be named the party authorized to build new capital projects that we are also pursuing. Because our Regulated Operating Subsidiaries are currently the only transmission companies that are independent from electricity market participants, we believe we are best able to develop these projects in a non-discriminatory manner. However, there are no assurances we will be selected to develop projects that other entities are also pursuing.

### Employees

As of December 31, 2012, we had 503 employees. We consider our relations with our employees to be good.





## Table of Contents

### Environmental Matters

Our 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 for failing 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 us. 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. 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 costs for such compliance in a manner that would be expected to have a material effect on our results of operations, financial position or liquidity.

Our 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 polychlorinated biphenyls (commonly known as PCBs). Our facilities and equipment are often situated close to or on property owned by others so that, if they are the source of contamination, the property of others may be affected. For example, aboveground and underground transmission lines sometimes traverse properties that we do not own, and, at some of our transmission stations, transmission assets (owned or operated by us) and distribution assets (owned or operated by our transmission customers) are commingled.

Some properties in which we have an ownership interest or at which we operate are, and others are suspected of being, affected by environmental contamination. We are not aware of any claims pending or threatened against us with respect to environmental contamination, or of any investigation or remediation of contamination at any properties, that entail costs likely to materially affect us. 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 we 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 claims pending or threatened against us 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.

### Filings Under the Securities Exchange Act of 1934

Our internet address is <http://www.itc-holdings.com>. You can access free of charge on our web site all of our reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports. These reports are available as soon as practicable after they are electronically filed with the Securities and Exchange Commission (the "SEC"). Also on our web site are our:

• Corporate Governance Guidelines;

• Code of Business Conduct and Ethics; and

• Committee Charters for the Audit and Finance Committee, Compensation Committee and Nominating/Corporate Governance Committee.

Our Code of Business Conduct and Ethics applies to all directors, officers and employees, including our Chairman, President and Chief Executive Officer and our Executive Vice President and Chief Financial Officer. We will post any

amendments to the Code of Business Conduct and Ethics, and any waivers that are required to

Table of Contents

be disclosed by the rules of either the SEC or the NYSE, on our web site within the required periods. The information on our web site is not incorporated by reference into this report.

To learn more about us, please visit our website at <http://www.itc-holdings.com>. We use our website as a channel of distribution of material company information. Financial and other material information regarding us is routinely posted on our website and is readily accessible.

You may also read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington DC, 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address is <http://www.sec.gov>.

ITEM 1A. RISK FACTORS.

Risks Related to Our Business

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

Our Regulated Operating Subsidiaries provide transmission service under rates regulated by the FERC. The FERC has approved the cost-based formula rate templates used by our Regulated Operating Subsidiaries, but it has not expressly approved the amount of actual capital and operating expenditures to be used in the formula rates. All aspects of our Regulated Operating Subsidiaries' rates approved by the FERC, including the formula rate templates, ITC Transmission's, METC's, ITC Midwest's and ITC Great Plains' respective allowed 13.88%, 13.38%, 12.38% and 12.16% rates of return on the actual equity portion of their respective capital structures, and the data inputs provided by our Regulated Operating Subsidiaries for calculation of each year's rate, are subject to challenge by interested parties at the FERC in a proceeding under Section 206 of the FPA. If a challenger can establish that any of these aspects are unjust, unreasonable, unduly discriminatory or preferential, then the FERC will make appropriate prospective adjustments to them and/or disallow any of our Regulated Operating Subsidiaries' inclusion of those aspects in the rate setting formula. This could result in lowered rates and/or refunds of amounts collected after the date that a Section 206 challenge is filed.

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 two transmission projects intended to improve the reliability and efficiency of our electric transmission system. Specifically, ITC Midwest made commitments to use commercially reasonable best efforts to complete these projects prior to December 31, 2009 and 2011, respectively. In the event ITC Midwest is found to have failed to meet these commitments, the allowed 12.38% rate of return on the actual equity portion of ITC Midwest's capital structure would be reduced to 10.39% until such time as ITC Midwest completes these projects, and ITC Midwest would refund with interest any amounts collected since the closing date of the transaction that exceeded what would have been collected if the 10.39% return on equity had been used. The project that was required to be completed prior to December 31, 2009 was completed by that deadline. With respect to the second project, the 345 kV Salem-Hazleton line, certain regulatory approvals were needed from the IUB before construction of the project could commence, but due to the IUB's case schedule, these approvals were not received until the second quarter of 2011. As a result of the delay in the receipt of the necessary regulatory approvals, the project was not completed by December 31, 2011. We believe we used commercially reasonable best efforts to meet the December 31, 2011 deadline.

Any of the events described above could have an adverse effect on our business, financial condition, results of operations and cash flows.

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



## Table of Contents

Each of our Regulated Operating Subsidiaries' rate base, revenues and earnings are determined in part by additions to property, plant and equipment when placed in service. We anticipate making significant capital investments over the next several years which include estimated transmission network upgrades for generator interconnections. The amounts for network upgrades could change significantly due to factors beyond our control, such as changes in the MISO queue for generation projects and whether the generator meets the various criteria of Attachment FF of the MISO Open Access Transmission, Energy, and Operating Reserve Markets Tariff for the project to qualify as a refundable network upgrade, among other factors. If our Regulated Operating Subsidiaries' capital expenditures and the resulting in-service property, plant and equipment are lower than anticipated for any reason, our Regulated Operating Subsidiaries will have a lower than anticipated rate base thus causing their revenue requirements and future earnings to be potentially lower than anticipated.

In addition, we are pursuing broader strategic development investment opportunities for transmission construction related to building regional transmission facilities, interconnections for generating resources, and other investment opportunities. The incumbent utilities or other entities with transmission development initiatives may compete with us by deciding to pursue capital projects that we are pursuing. These estimates of potential investment opportunities are based primarily on foreseeable transmission needs and general transmission construction costs, not necessarily on particular project cost estimates.

Any capital investment at our Regulated Operating Subsidiaries or as a result of our broader strategic development initiatives may be lower than expected due to, among other factors, the impact of actual loads, forecasted loads, regional economic conditions, weather conditions, union strikes, labor shortages, material and equipment prices and availability, our ability to obtain financing for such expenditures, if necessary, limitations on the amount of construction that can be undertaken on our system or transmission systems owned by others at any one time, regulatory approvals for reasons relating to rate construct, environmental, siting, regional planning, cost recovery or other issues or as a result of legal proceedings and variances between estimated and actual costs of construction contracts awarded. Our ability to engage in construction projects resulting from pursuing these initiatives is subject to significant uncertainties, including the factors discussed above, and will depend on obtaining any necessary regulatory and other approvals for the project and for us to initiate construction, our achieving status as the builder of the project in some circumstances and other factors. Therefore, we can provide no assurance as to the actual level of investment we may achieve at our Regulated Operating Subsidiaries or as a result of the broader strategic development initiatives. The regulations to which we are subject may limit our ability to raise capital and/or pursue acquisitions, development opportunities or other transactions or may subject us to liabilities.

Each of our Regulated Operating Subsidiaries is a "public utility" under the FPA and, accordingly, is subject to regulation by the FERC. Approval of the FERC is required under Section 203 of the FPA for a disposition or acquisition of regulated public utility facilities, either directly or indirectly through a holding company. Such approval may also be required to acquire securities in a public utility. Section 203 of the FPA also provides the FERC with explicit authority over utility holding companies' purchases or acquisitions of, and mergers or consolidations with, a public utility. Finally, each of our Regulated Operating Subsidiaries must also seek approval by the FERC under Section 204 of the FPA for issuances of its securities (including debt securities).

We are also pursuing development projects for construction of transmission facilities and interconnections with generating resources. These projects may require regulatory approval by the FERC, applicable RTOs and state and local regulatory agencies. Failure to secure such regulatory approval for new strategic development projects could adversely affect our ability to grow our business and increase our revenues. If we fail to obtain these approvals when necessary, we may incur liabilities for such failure.

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

The formula rate templates used by our Regulated Operating Subsidiaries to calculate their respective annual revenue requirements will be used by our Regulated Operating Subsidiaries for that purpose until and unless the FERC determines that such formula rates are unjust and unreasonable and that another rate is just and reasonable. Such a determination could result from challenges initiated at the FERC by interested parties, or by the FERC on its own initiative, in a proceeding under Section 206 of the FPA. An existing formula rate also could be replaced by a

successful application initiated by any of our Regulated Operating Subsidiaries under Section 205 of the FPA.  
End-use consumers and entities supplying electricity to end-use consumers may attempt to influence government

Table of Contents

and/or regulators to change the rate setting methodologies that apply to our Regulated Operating Subsidiaries, particularly if rates for delivered electricity increase substantially.

Each of our Regulated Operating Subsidiaries is regulated by the FERC as a “public utility” under the FPA and is a transmission owner in MISO or SPP. We cannot predict whether the approved rate methodologies for any of our Regulated Operating Subsidiaries will be changed. In addition, the U.S. Congress periodically considers enacting energy legislation that could shift new responsibilities to the FERC, modify provisions of the FPA or provide the FERC or another entity with increased authority to regulate transmission matters. We cannot predict whether, and to what extent, our Regulated Operating Subsidiaries may be affected by any such changes in federal energy laws, regulations or policies in the future.

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

If amounts billed for transmission service are lower than expected, which could result from lower network load or point-to-point transmission service on our Regulated Operating Subsidiaries’ transmission systems due to a weak economy, changes in the nature or composition of the transmission assets of our Regulated Operating Subsidiaries and surrounding areas, poor transmission quality of neighboring transmission systems, or for any other reason, the timing of the collection of our revenue requirement would likely be delayed until such circumstances are adjusted through the true-up mechanism in our Regulated Operating Subsidiaries’ formula rate templates. In addition, if the revenue requirements of our Regulated Operating Subsidiaries are higher than expected, the timing of the collection of our Regulated Operating Subsidiaries’ revenue requirements would likely be delayed until such circumstances are reflected through the true-up mechanism in our Regulated Operating Subsidiaries’ expected, formula rate templates.

The effect of such under-collection would be to reduce the amount of our available cash resources from what we had expected, until such under-collection is corrected through the true-up mechanism in the formula rate template, which may require us to increase our outstanding indebtedness, thereby reducing our available borrowing capacity, and may require us to pay interest at a rate that exceeds the interest to which we are entitled in connection with the operation of the true-up mechanism.

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

ITCTransmission derives a substantial portion of its revenues from the transmission of electricity to Detroit Edison’s local distribution facilities. Detroit Edison accounted for approximately 75.0% of ITCTransmission’s total operating revenues for the year ended December 31, 2012 and is expected to constitute the majority of ITCTransmission’s revenues for the foreseeable future. Detroit Edison is rated BBB+/stable and Baa1/positive by Standard & Poor’s Ratings Services and Moody’s Investors Services, Inc., respectively. Similarly, Consumers Energy accounted for approximately 78.2% of METC’s total operating revenues for the year ended December 31, 2012 and is expected to constitute the majority of METC’s revenues for the foreseeable future. Consumers Energy is rated BBB-/positive and Baa2/positive by Standard & Poor’s Ratings Services and Moody’s Investors Service, Inc., respectively. Further, IP&L accounted for approximately 80.0% of ITC Midwest’s total operating revenues for the year ended December 31, 2012 and is expected to constitute the majority of ITC Midwest’s revenues for the foreseeable future. IP&L is rated A-/stable and A3/stable by Standard & Poor’s Ratings Services and Moody’s Investors Service, Inc., respectively. These percentages of total operating revenues of Detroit Edison, Consumers Energy and IP&L include an estimate for the 2012 revenue accrual and deferrals that were included in our 2012 operating revenues, but will not be billed to our customers until 2014. We have assumed that the revenues billed to these customers in 2014 would be in the same proportion of the respective percentages of network and regional cost sharing revenues billed to them in 2012.

Any material failure by Detroit Edison, Consumers Energy or IP&L to make payments for transmission services could have an adverse effect on our business, financial condition, results of operations and cash flows.

A significant amount of the land on which our Regulated Operating Subsidiaries’ assets are located is subject to easements, mineral rights and other similar encumbrances. As a result, our Regulated Operating Subsidiaries must comply with the provisions of various easements, mineral rights and other





## Table of Contents

similar encumbrances, which may adversely impact their ability to complete construction projects in a timely manner. METC does not own the majority of the land on which its electric transmission assets are located. Instead, under the provisions of an Easement Agreement with Consumers Energy, METC pays annual rent of \$10.0 million to Consumers Energy in exchange for rights-of-way, leases, fee interests and licenses which allow METC to use the land on which its transmission lines are located. Under the terms of the Easement Agreement, METC's easement rights could be eliminated if METC fails to meet certain requirements, such as paying contractual rent to Consumers Energy in a timely manner. Additionally, a significant amount of the land on which ITC Transmission's, ITC Midwest's and ITC Great Plains' assets are located is subject to easements, mineral rights and other similar encumbrances. As a result, they must comply with the provisions of various easements, mineral rights and other similar encumbrances, which may adversely impact their ability to complete their construction projects in a timely manner.

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

Our Regulated Operating Subsidiaries enter into various agreements and arrangements with third parties to provide services for the operation of certain aspects of their businesses, which, if terminated could result in a shortage of a readily available workforce to provide these services. For example, ITC Midwest and IP&L have entered into the Operations Services Agreement For 34.5 kV Transmission Facilities (the "OSA"), under which IP&L performs certain operations functions for ITC Midwest's 34.5 kV transmission system. The OSA's term is from January 1, 2011 until December 31, 2015, and by its terms will remain in full force and effect from year to year thereafter until terminated by either party upon not less than one year's prior written notice to the other party. If the OSA is terminated for any reason or at a time when ITC Midwest is unprepared for such termination, ITC Midwest may face difficulty finding a qualified replacement work force to provide such services, which could have an adverse effect on its ability to carry on its business and on its results of operations.

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

The operations of our Regulated Operating Subsidiaries are subject to the usual hazards associated with high-voltage electricity transmission, including explosions, fires, inclement weather, natural disasters, mechanical failure, unscheduled downtime, equipment interruptions, remediation, chemical spills, discharges or releases of toxic or hazardous substances or gases and other environmental risks. The hazards can cause personal injury and loss of life, severe damage to or destruction of property and equipment and environmental damage, and may result in suspension of operations and the imposition of civil or criminal penalties. We maintain property and casualty insurance, but we are not fully insured against all potential hazards incident to our business, such as damage to poles, towers and lines or losses caused by outages.

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

The operations of our Regulated Operating Subsidiaries 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. Environmental requirements generally have become more stringent in recent years, and compliance with those requirements more expensive.

Our Regulated Operating Subsidiaries have incurred expenses in connection with environmental compliance, and we anticipate that each will continue to do so in the future. Failure to comply with the extensive environmental laws and

regulations applicable to each could result in significant civil or criminal penalties and remediation costs.

## Table of Contents

Our Regulated Operating Subsidiaries' assets and operations also involve the use of materials classified as hazardous, toxic, or otherwise dangerous. Some of our Regulated Operating Subsidiaries' facilities and properties are located near environmentally sensitive areas such as wetlands and habitats of endangered or threatened species. In addition, certain properties in which our Regulated Operating Subsidiaries operate are, or are suspected of being, affected by environmental contamination. Compliance with these laws and regulations, and liabilities concerning contamination or hazardous materials, may adversely affect our costs and, therefore, our business, financial condition and results of operations.

In addition, 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. We cannot assure you that such claims will not be asserted against us or that, if determined in a manner adverse to our interests, such claims would not have a material effect on our business, financial condition and results of operations. Our Regulated Operating Subsidiaries are subject to various regulatory requirements, including reliability standards; contract filing requirements; reporting, recordkeeping and accounting requirements; and transaction approval requirements. Violations of these requirements, whether intentional or unintentional, may result in penalties that, under some circumstances, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The various regulatory requirements to which we are subject include reliability standards established by the NERC, which acts as the nation's Electric Reliability Organization approved by the FERC in accordance with Section 215 of the FPA. These standards address operation, planning and security of the bulk power system, including requirements with respect to real-time transmission operations, emergency operations, vegetation management, critical infrastructure protection and personnel training. Failure to comply with these requirements can result in monetary penalties as well as non-monetary sanctions. Monetary penalties vary based on an assigned risk factor for each potential violation, the severity of the violation and various other circumstances, such as whether the violation was intentional or concealed, whether there are repeated violations, the degree of the violator's cooperation in investigating and remediating the violation and the presence of a compliance program. Penalty amounts range from \$1,000 to a maximum of \$1.0 million per day, depending on the severity of the violation. Non-monetary sanctions include potential limitations on the violator's activities or operation and placing the violator on a watchlist for major violators. Despite our best efforts to comply and the implementation of a compliance program intended to ensure reliability, there can be no assurance that violations will not occur that would result in material penalties or sanctions. If any of our Regulated Operating Subsidiaries were to violate the NERC reliability standards, even unintentionally, in any material way, any penalties or sanctions imposed against us could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The Regulated Operating Subsidiaries are also subject to requirements under Sections 203 and 205 of the FPA for approval of transactions; reporting, recordkeeping and accounting requirements; and for filing contracts related to the provision of jurisdictional services. Under FERC policy, failure to file jurisdictional agreements on a timely basis may result in foregoing the time value of revenues collected under the agreement, but not to the point where a loss would be incurred. The failure to obtain timely approval of transactions subject to FPA Section 203, or to comply with applicable reporting, recordkeeping or accounting requirements under FPA Section 205, could subject us to penalties that could have a material adverse effect on our financial condition, results of operations and cash flows.

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

Acts of war, terrorist attacks and threats, including cyber attacks or threats, or the escalation of military activity in response to such attacks or otherwise may negatively affect our business, financial condition and cash flows in unpredictable ways, such as increased security measures and disruptions of markets. Strategic targets, such as energy related assets, including, for example, our Regulated Operating Subsidiaries' transmission facilities and Detroit Edison's, Consumers Energy's and IP&L's generation and distribution facilities, may be at risk of future terrorist attacks or threats, including cyber attacks or threats. In addition to the increased costs associated with heightened security requirements, such events may have a material effect on the economy in general. A lower level of economic activity

could result in a decline in energy consumption, which may adversely affect our business, financial condition, results of operations and cash flows.

## Table of Contents

### Risks Relating to Our Structure and Financial Leverage

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

As a holding company with no business operations, ITC Holdings' material assets consist primarily of the stock and membership interests in our Regulated Operating Subsidiaries and our other subsidiaries, deferred tax assets and cash on hand. Our only sources of cash to pay dividends to our stockholders are dividends and other payments received by us from time to time from our Regulated Operating Subsidiaries and our other subsidiaries and the proceeds raised from the sale of our debt and equity securities. Each of our Regulated Operating Subsidiaries, however, is legally distinct from us and has no obligation, contingent or otherwise, to make funds available to us for the payment of dividends to ITC Holdings' stockholders or otherwise. The ability of each of our Regulated Operating Subsidiaries and our other subsidiaries to pay dividends and make other payments to us is subject to, among other things, the availability of funds, after taking into account capital expenditure requirements, the terms of its indebtedness, applicable state laws and regulations of the FERC and the FPA. Our Regulated Operating Subsidiaries target a FERC-approved capital structure of 60% equity and 40% debt that may limit the ability of our Regulated Operating Subsidiaries to use net assets for the payment of dividends to ITC Holdings. While we currently intend to continue to pay quarterly dividends on our common stock, we have no obligation to do so. The payment of dividends is within the absolute discretion of our board of directors and will depend on, among other things, our results of operations, working capital requirements, capital expenditure requirements, financial condition, contractual restrictions, anticipated cash needs and other factors that our board of directors deems relevant.

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

We are highly leveraged and our consolidated indebtedness consists of various outstanding debt securities and borrowings under various revolving and term loan credit agreements. This capital structure can have several important consequences, including, but not limited to, the following:

- If future cash flows are insufficient, we may not be able to make principal or interest payments on our debt obligations, which could result in the occurrence of an event of default under one or more of those debt instruments.

- We may need to incur further indebtedness in order to make the capital expenditures and other expenses or investments planned by us.

Our indebtedness has the general effect of reducing our flexibility to react to changing business and economic conditions insofar as they affect our financial condition and, therefore, may pose substantial risk to our shareholders.

- A substantial portion of the dividends and payments in lieu of taxes we receive from our Regulated Operating Subsidiaries will be dedicated to the payment of interest on our indebtedness, thereby reducing the funds available for working capital, capital expenditures and the payment of dividends on our common stock.

- In the event that we are liquidated, our senior or subordinated creditors and the senior or subordinated creditors of our subsidiaries will be entitled to payment in full prior to any distributions to the holders of shares of our common stock.

We currently have debt instruments outstanding with relatively short remaining maturities. Our ability to secure additional financing prior to or after these facilities mature, if needed, may be substantially restricted by the existing level of our indebtedness and the restrictions contained in our debt instruments. Additionally, the interest rates at which we might secure additional financings may be higher than our currently outstanding debt instruments or higher than forecasted at any point in time, which could adversely affect our business, financial condition, results of operations and cash flows.

Market conditions could affect our access to capital markets, restrict our ability to secure financing to make the capital expenditures and investments and pay other expenses planned by us and could affect our interest rate swap obligations which could adversely affect our business, financial condition, cash flows and results of operations.

We may incur substantial indebtedness in the future, including in connection with the Entergy Transaction. The incurrence of additional indebtedness would increase the leverage-related risks described above.



## Table of Contents

Certain provisions in our debt instruments limit our financial flexibility.

Our debt instruments include senior notes, secured notes, first mortgage bonds, and revolving and term loan credit agreements containing numerous financial and operating covenants that place significant restrictions on, among other things, our ability to:

- incur additional indebtedness;
- engage in sale and lease-back transactions;
- create liens or other encumbrances;
- enter into mergers, consolidations, liquidations or dissolutions, or sell or otherwise dispose of all or substantially all of our assets;
- create and acquire subsidiaries; and
- pay dividends or make distributions on our and ITC Transmission's capital stock and METC's, ITC Midwest's, and ITC Great Plains' member capital.

Our debt instruments also require us to meet certain financial ratios, such as maintaining certain debt to capitalization ratios. Our ability to comply with these and other requirements and restrictions may be affected by changes in economic or business conditions, results of operations or other events beyond our control. A failure to comply with the obligations contained in any of our debt instruments could result in acceleration of the related debt and the acceleration of debt under other instruments evidencing indebtedness that may contain cross-acceleration or cross-default provisions.

Adverse changes in our credit ratings may negatively affect us.

Our ability to access capital markets is important to our ability to operate our business. Increased scrutiny of the energy industry and the impact of regulation, as well as changes in our financial performance and unfavorable conditions in the capital markets could result in credit agencies reexamining our credit ratings. A downgrade in our credit ratings could restrict or discontinue our ability to access capital markets at attractive rates and increase our borrowing costs. A rating downgrade could also increase the interest we pay under our revolving and term loan credit agreements.

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

Our Articles of Incorporation and bylaws contain provisions that might enable our management to resist a proposed takeover. These provisions could discourage, delay or prevent a change of control or an acquisition at a price that our shareholders may find attractive. These provisions also may discourage proxy contests and make it more difficult for our shareholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors are willing to pay in the future for shares of our common stock. These provisions include:

- a restriction limiting market participants from voting or owning 5% or more of the outstanding shares of our capital stock;
- a requirement that special meetings of our shareholders may be called only by our board of directors, the chairman of our board of directors, our president or the holders of a majority of the shares of our outstanding common stock;
- advance notice requirements for shareholder proposals and nominations; and
- the authority of our board to issue, without shareholder approval, common or preferred stock, including in connection with our implementation of any shareholders rights plan, or "poison pill."

In addition, our revolving and term loan credit agreements provide that a change in a majority of ITC Holdings' board of directors that is not approved by the current ITC Holdings directors or acquiring beneficial ownership of 35% or more of ITC Holdings outstanding common shares will constitute a default under those agreements.

## Table of Contents

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

Certain of our Regulated Operating Subsidiaries have been granted favorable rate treatment by the FERC based on their independence from market participants. The FERC defines a “market participant” to include any person or entity that, either directly or through an affiliate, sells or brokers electricity, or provides ancillary services to an RTO. An affiliate, for these purposes, includes any person or entity that directly or indirectly owns, controls or holds with the power to vote 5% or more of the outstanding voting securities of a market participant. To help ensure that we and our subsidiaries will remain independent of market participants, our Articles of Incorporation impose certain restrictions on the ownership and voting of shares of our capital stock by market participants. In particular, the Articles of Incorporation provide that we are restricted from issuing any shares of capital stock or recording any transfer of shares if the issuance or transfer would cause any market participant, either individually or together with members of its “group” (as defined in SEC beneficial ownership rules), to beneficially own 5% or more of any class or series of our capital stock. Additionally, if a market participant, together with its group members, acquires beneficial ownership of 5% or more of any series of the outstanding shares of our capital stock, such market participant or any shareholder who is a member of a group including a market participant will not be able to vote or direct or control the votes of shares representing 5% or more of any series of our outstanding capital stock. Finally, to the extent a market participant, together with its group members, acquires beneficial ownership of 5% or more of the outstanding shares of any series of our capital stock, our Articles of Incorporation allow our board of directors to redeem any shares of our capital stock so that, after giving effect to the redemption, the market participant, together with its group members, will cease to beneficially own 5% or more of that series of our outstanding capital stock.

### Risks Related to the Entergy Transaction

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

The consummation of the Entergy Transaction is subject to numerous conditions, including (i) consummation of certain transactions and financings contemplated by the merger agreement and the separation agreement (such as the separation of Entergy’s transmission business from its distribution business), (ii) the receipt of ITC Holdings shareholder approval, and (iii) the receipt of certain regulatory approvals in a form that will not impose a burdensome condition on us or Entergy (as described in the merger agreement). We can make no assurances that the Entergy Transaction will be consummated on the terms or timeline currently contemplated, or at all. We have and will continue to expend management’s time and resources and incur expenses due to legal, advisory and financial services fees related to the Entergy Transaction. Governmental agencies may not approve the Entergy Transaction or the related transactions necessary to complete it, or may impose conditions to any such approval or require changes to the terms of the Entergy Transaction. Any such conditions or changes could have the effect of delaying completion of the Entergy Transaction, imposing costs on or limiting the revenues of the combined company following the Entergy Transaction or otherwise reducing the anticipated benefits of the Entergy Transaction. Any condition or change which results in a burdensome condition on Entergy’s transmission business and/or us under the merger agreement and might cause Entergy and/or us to restructure or terminate the Entergy Transaction or the related transactions.

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

If the Entergy Transaction is completed, we may not successfully realize anticipated growth opportunities or integrate our business and operations with the acquired transmission business and operations. After the Entergy Transaction, we will have significantly more revenue, expenses, assets and employees than we did prior to the Entergy Transaction. In the Entergy Transaction, we will also be assuming certain liabilities of Entergy's transmission business and taking on other obligations (including collective bargaining agreements and certain pension obligations with respect to transferred employees). We may not successfully or cost-effectively integrate the acquired transmission business and operations into our business and operations. Even if the combined company is able to integrate the transmission businesses and operations successfully, this integration may not result in the realization of the full benefits of the growth opportunities that we currently expect from the Entergy Transaction within the anticipated time frame, or at all.





## Table of Contents

The merger agreement contains provisions that may discourage other companies from trying to acquire us. The merger agreement contains provisions that may discourage a third party from submitting a business combination proposal to us prior to the closing of the Entergy Transaction that might result in greater value to ITC Holdings shareholders than the Entergy Transaction. The merger agreement generally prohibits us from soliciting any alternative acquisition proposal, although we may terminate the merger agreement in order to accept an unsolicited alternative transaction proposal that our board of directors determines is superior to the Entergy Transaction. In addition, before our board may withdraw or modify its recommendation or we may terminate the merger agreement to enter into a transaction that our board determines is superior to the Entergy Transaction, Entergy has the opportunity to negotiate with us to modify the terms of the Entergy Transaction in response to any competing acquisition proposals that may be made. If the merger agreement is terminated by us or Entergy in certain limited circumstances, we may be obligated to pay a termination fee to Entergy, which would represent an additional cost for a potential third party seeking a business combination with us.

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

If the Entergy Transaction is not completed for any reason, the price of ITC Holdings common stock may decline to the extent that the market price of ITC Holdings common stock reflects positive market assumptions that the Entergy Transaction will be completed and the related benefits will be realized. In addition, significant expenses such as legal, advisory and financial services, many of which generally will be paid incurred regardless of whether the Entergy Transaction is completed, must be paid. Under the merger agreement, under certain limited circumstances, we must pay Entergy a termination fee.

Investors holding shares of ITC Holdings common stock immediately prior to the completion of the Entergy Transaction will, in the aggregate, have a significantly reduced ownership and voting interest in us after the Entergy Transaction and will exercise less influence over management.

Investors holding shares of ITC Holdings common stock immediately prior to the completion of the Entergy Transaction will, in the aggregate, own a significantly smaller percentage of the combined company immediately after the completion of the Entergy Transaction. Immediately following the completion of the Entergy Transaction, it is expected that Entergy shareholders will hold at least 50.1% of the ITC Holdings common stock on a fully diluted basis and existing ITC Holdings shareholders will hold no more than 49.9% of ITC Holdings common stock on a fully diluted basis (subject to adjustment in limited circumstances as provided in the merger agreement) and excluding any ITC equity awards issued to employees of the acquired business who become employees of our subsidiaries. In no event will Entergy shareholders hold less than 50.1% of our outstanding common stock immediately after the Entergy Transaction. Consequently, ITC Holdings shareholders, collectively, will be able to exercise less influence over the management and policies of the combined company than they are able to exercise over the management and our policies immediately prior to the completion of the Entergy Transaction.

After the completion of the merger, sales of ITC Holdings common stock may negatively affect its market price. The shares of ITC Holdings common stock to be issued in the merger to Entergy shareholders will generally be eligible for immediate resale. The market price of ITC Holdings common stock could decline as a result of sales of a large number of shares of ITC Holdings common stock in the market after the completion of the merger or the perception in the market that these sales could occur.

Immediately following the completion of the merger, it is expected that former Entergy shareholders will hold approximately 50.1% of ITC Holdings' common stock on a fully diluted basis and existing ITC Holdings shareholders will hold approximately 49.9% of ITC Holdings' common stock on a fully diluted basis (subject to adjustment in limited circumstances as provided in the merger agreement and excluding any ITC Holdings equity awards issued to employees of Entergy's transmission business who become our employees). In no event will Entergy shareholders hold less than 50.1% of the outstanding common stock of ITC Holdings immediately after the merger. Certain former Entergy shareholders (such as certain index funds and institutional investors with specific investment guidelines that do not pertain to the stock of the combined company) who receive shares of ITC Holdings common stock pursuant to the merger agreement may be required to sell their shares of ITC Holdings common stock immediately after the merger, which may negatively affect the price of ITC Holdings' common stock following the merger.



Table of Contents

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

The merger agreement and the separation agreement impose certain ongoing restrictions on us to ensure that applicable statutory requirements under the Internal Revenue Code of 1986, as amended, and applicable Treasury regulations are met so that the Entergy Transaction qualifies as tax-free to Entergy and its shareholders. As a result of these restrictions, our ability to engage in certain transactions, such as the redemption of ITC Holdings common stock or the issuance of our equity securities (subject to certain exceptions generally relating to compensation) may be limited until two years and one day following the closing of the Entergy Transaction (excluding the \$700 million recapitalization in the form of a one-time special dividend and/or share repurchase to be completed in connection with the Entergy Transaction).

If we take any of an enumerated list of actions and omissions that would cause the Entergy Transaction to become taxable, we generally will be required to bear the cost of any resulting tax liability. If the Entergy Transaction became taxable, Entergy would be expected to recognize a substantial amount of income, which would result in a material amount of taxes. Any such taxes allocated to us would be expected to be material to us, and could cause our business, financial condition and operating results to suffer. These restrictions may reduce our ability to engage in certain business transactions that otherwise might be advantageous to us.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

Our Regulated Operating Subsidiaries' transmission facilities are located in Michigan's Lower Peninsula and portions of Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma. Our MISO Regulated Operating Subsidiaries have agreements with other utilities for the joint ownership of specific substations and transmission lines. See Note 15 to the consolidated financial statements.

ITCTransmission owns the assets of a transmission system and related assets, including:

- approximately 2,800 circuit miles of overhead and underground transmission lines rated at voltages of 120 kV to 345 kV;

- approximately 17,700 transmission towers and poles;

- station assets, such as transformers and circuit breakers, at 171 stations and substations which either interconnect ITCTransmission's transmission facilities or connect ITCTransmission's facilities with generation or distribution facilities owned by others;

- other transmission equipment necessary to safely operate the system (e.g., monitoring and metering equipment);

- warehouses and related equipment;

- associated land held in fee, rights of way and easements;

- an approximately 188,000 square-foot corporate headquarters facility and operations control room in Novi, Michigan, including furniture, fixtures and office equipment; and

- an approximately 40,000 square-foot facility in Ann Arbor, Michigan that includes a back-up operations control room.

ITCTransmission's First Mortgage Bonds are issued under ITCTransmission's First Mortgage and Deed of Trust. As a result, the bondholders have the benefit of a first mortgage lien on substantially all of ITCTransmission's property.

METC owns the assets of a transmission system and related assets, including:

- approximately 5,600 circuit miles of overhead transmission lines rated at voltages of 120 kV to 345 kV;

- approximately 36,900 transmission towers and poles;

## Table of Contents

station assets, such as transformers and circuit breakers, at 98 stations and substations which either interconnect METC's transmission facilities or connect METC's facilities with generation or distribution facilities owned by others; other transmission equipment necessary to safely operate the system (e.g., monitoring and metering equipment); and warehouses and related equipment.

METC's Senior Secured Notes are issued under METC's First Mortgage Indenture. As a result, the noteholders have the benefit of a first mortgage lien on substantially all of METC's property.

METC does not own the majority of the land on which its assets are located, but under the provisions of its Easement Agreement with Consumers Energy, METC has an easement to use the land, rights-of-way, leases and licenses in the land on which its transmission lines are located that are held or controlled by Consumers Energy. See "Item 1 Business — Operating Contracts — METC — Amended and Restated Easement Agreement."

ITC Midwest owns the assets of a transmission system and related assets, including:

• approximately 6,600 circuit miles of transmission lines rated at voltages of 34.5 kV to 345 kV;

• transmission towers and poles;

• station assets, such as transformers and circuit breakers, at approximately 262 stations and substations which either interconnect ITC Midwest's transmission facilities or connect ITC Midwest's facilities with generation or distribution facilities owned by others;

• other transmission equipment necessary to safely operate the system (e.g., monitoring and metering equipment);

• warehouses and related equipment; and

• associated land held in fee, rights of way and easements.

ITC Midwest's First Mortgage Bonds are issued under ITC Midwest's First Mortgage and Deed of Trust. As a result, the bondholders have the benefit of a first mortgage lien on substantially all of ITC Midwest's property.

ITC Great Plains owns the assets of a transmission system and related assets including:

• approximately 190 miles of transmission lines rated at a voltage of 345 kV;

• approximately 1,168 transmission towers and poles;

• station assets, such as transformers and circuit breakers, at 5 stations and substations which either interconnect ITC Great Plains' transmission facilities or connect ITC Great Plains' facilities with transmission, generation or distribution facilities owned by others;

• other transmission equipment necessary to safely operate the system (e.g., monitoring and metering equipment); and

• associated land held in fee, rights of way and easements.

As of December 31, 2012, there were no liens or encumbrances on the assets of ITC Great Plains.

The assets of our Regulated Operating Subsidiaries are suitable for electric transmission and adequate for the electricity demand in our service territory. We prioritize capital spending based in part on meeting reliability standards within the industry. This includes replacing and upgrading existing assets as needed.

### ITEM 3. LEGAL PROCEEDINGS.

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.

Table of Contents

Refer to Notes 4 and 16 to the consolidated financial statements for a description of pending litigation.

## ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

## Stock Price and Dividends

Our common stock has traded on the NYSE since July 26, 2005 under the symbol "ITC". Prior to that time, there was no public market for our stock. As of February 26, 2013, there were approximately 648 shareholders of record of our common stock.

The following tables set forth the high and low sales price per share of the common stock for each full quarterly period in 2012 and 2011, as reported on the NYSE and the cash dividends per share paid during the periods indicated.

| Year Ended December 31, 2012     | High    | Low     | Dividends |
|----------------------------------|---------|---------|-----------|
| Quarter ended December 31, 2012  | \$79.75 | \$74.28 | \$0.3775  |
| Quarter ended September 30, 2012 | \$75.87 | \$69.10 | \$0.3775  |
| Quarter ended June 30, 2012      | \$78.86 | \$66.30 | \$0.3525  |
| Quarter ended March 31, 2012     | \$78.51 | \$71.65 | \$0.3525  |
| <br>                             |         |         |           |
| Year Ended December 31, 2011     | High    | Low     | Dividends |
| Quarter ended December 31, 2011  | \$81.90 | \$70.00 | \$0.3525  |
| Quarter ended September 30, 2011 | \$78.89 | \$64.88 | \$0.3525  |
| Quarter ended June 30, 2011      | \$74.67 | \$67.46 | \$0.3350  |
| Quarter ended March 31, 2011     | \$70.28 | \$61.76 | \$0.3350  |

The declaration and payment of dividends is subject to the discretion of ITC Holdings' board of directors and depends on various factors, including our net income, financial condition, cash requirements, future prospects and other factors deemed relevant by ITC Holdings' board of directors. As a holding company with no business operations, ITC Holdings' material assets consist primarily of the common stock or ownership interests in its subsidiaries, deferred tax assets and cash. ITC Holdings' material cash inflows are only from dividends and other payments received from time to time from its subsidiaries and the proceeds raised from the sale of debt and equity securities. ITC Holdings may not be able to access cash generated by its subsidiaries in order to pay dividends to shareholders. The ability of ITC Holdings' subsidiaries to make dividend and other payments to ITC Holdings is subject to the availability of funds after taking into account the subsidiaries' funding requirements, the terms of the subsidiaries' indebtedness, the regulations of the FERC under FPA, and applicable state laws. The debt agreements to which we are parties contain numerous financial covenants that could limit ITC Holdings' ability to pay dividends, as well as covenants that prohibit ITC Holdings from paying dividends if we are in default under our revolving and term loan credit facilities. Further, each of our subsidiaries is legally distinct from ITC Holdings and has no obligation, contingent or otherwise, to make funds available to ITC Holdings.

If and when ITC Holdings pays a dividend on its common stock, pursuant to our special bonus plans for executives and certain non-executive employees, amounts equivalent to the dividend may be paid to the special bonus plan participants, if approved by the compensation committee. We currently expect these amounts to be paid upon the declaration of dividends on ITC Holdings' common stock.

The board of directors intends to increase the dividend rate from time to time as necessary to maintain an appropriate dividend payout ratio, subject to prevailing business conditions, applicable restrictions on dividend payments, the availability of capital resources and our investment opportunities.

Prior to closing the Entergy Transaction, we expect to effectuate a \$700 million 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.



Table of Contents

See discussion of certain restrictions on our ability to pay dividends related to the Entergy Transaction as discussed under “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Capital Project Updates and Other Recent Developments.”

The transfer agent for the common stock is Computershare Trust Company, N.A., P.O. Box 43078 Providence, RI 02940-3078.

In addition, the information contained in the Equity Compensation table under “Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” of this report is incorporated herein by reference.

**Stock Repurchases**

The following table sets forth, the repurchases of common stock for the quarter ended December 31, 2012:

| Period        | Total Number of<br>Shares Purchased<br>(1) | Average Price<br>Paid per Share | Total Number of<br>Shares Purchased<br>as<br>Part of Publicly<br>Announced Plan<br>or Program (2) | Maximum Number or<br>Approximate Dollar<br>Value of Shares that<br>May<br>Yet Be Purchased<br>Under the Plans or<br>Programs (2) |
|---------------|--|---------------------------------|---|--|
| October 2012  | —  | \$—                             | —   | —  |
| November 2012 | 192  | 76.90                           | —   | —  |
| December 2012 | 30,158                                     | 78.08                           | —   | —  |
| Total         | 30,350                                     | \$78.07                         | —   | —  |

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

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



Table of Contents

## ITEM 6. SELECTED FINANCIAL DATA.

The selected historical financial data presented below should be read together with our consolidated financial statements and the notes to those statements and “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included elsewhere in this Form 10-K.

|   | ITC Holdings and Subsidiaries |             |             |             |           |
|---|-------------------------------|-------------|-------------|-------------|-----------|
|   | Year Ended December 31,       |             |             |             |           |
| (In thousands, except per share data)               | 2012                          | 2011        | 2010        | 2009        | 2008      |
| OPERATING REVENUES                                  | \$830,535                     | \$757,397   | \$696,843   | \$621,015   | \$617,877 |
| OPERATING EXPENSES                                  |                               |             |             |             |           |
| Operation and maintenance (a)                       | 121,941                       | 129,288     | 126,528     | 95,730      | 113,818   |
| General and administrative (a) (b) (c)              | 112,091                       | 82,790      | 78,120      | 69,231      | 81,296    |
| Depreciation and amortization (d)                   | 106,512                       | 94,981      | 86,976      | 85,949      | 94,769    |
| Taxes other than income taxes                       | 59,701                        | 53,430      | 48,195      | 43,905      | 41,180    |
| Other operating (income) and expense — net          | (769)                         | (844)       | (297)       | (667)       | (809)     |
| Total operating expenses                            | 399,476                       | 359,645     | 339,522     | 294,148     | 330,254   |
| OPERATING INCOME                                    | 431,059                       | 397,752     | 357,321     | 326,867     | 287,623   |
| OTHER EXPENSES (INCOME)                             |                               |             |             |             |           |
| Interest expense                                    | 155,734                       | 146,936     | 142,553     | 130,209     | 122,234   |
| Allowance for equity funds used during construction | (23,000)                      | (16,699)    | (13,412)    | (13,203)    | (11,610)  |
| Loss on extinguishment of debt                      | —                             | —           | —           | 1,263       | —         |
| Other income  | (2,401)                       | (2,881)     | (2,340)     | (2,792)     | (3,415)   |
| Other expense                                       | 4,218                         | 3,962       | 2,588       | 2,918       | 3,944     |
| Total other expenses (income)                       | 134,551                       | 131,318     | 129,389     | 118,395     | 111,153   |
| INCOME BEFORE INCOME TAXES                          | 296,508                       | 266,434     | 227,932     | 208,472     | 176,470   |
| INCOME TAX PROVISION                                | 108,632                       | 94,749      | 82,254      | 77,572      | 67,262    |
| NET INCOME  | \$187,876                     | \$171,685   | \$145,678   | \$130,900   | \$109,208 |
| Basic earnings per share                            | \$3.65                        | \$3.36      | \$2.89      | \$2.62      | \$2.22    |
| Diluted earnings per share                          | \$3.60                        | \$3.31      | \$2.84      | \$2.58      | \$2.18    |
| Dividends declared per share                        | \$1.460                       | \$1.375     | \$1.310     | \$1.250     | \$1.190   |
|   | ITC Holdings and Subsidiaries |             |             |             |           |
|   | As of December 31,            |             |             |             |           |
| (In thousands)                                      | 2012                          | 2011        | 2010        | 2009        | 2008      |
| BALANCE SHEET DATA:                                 |                               |             |             |             |           |
| Cash and cash equivalents                           | \$26,187                      | \$58,344    | \$95,109    | \$74,853    | \$58,110  |
| Working capital (deficit)                           | (805,085)                     | (113,939)   | 69,338      | 147,335     | 1,095     |
| Property, plant and equipment — net                 | 4,134,579                     | 3,415,823   | 2,872,277   | 2,542,064   | 2,304,386 |
| Goodwill  | 950,163                       | 950,163     | 950,163     | 950,163     | 951,319   |
| Total assets  | 5,564,809                     | 4,823,366   | 4,307,873   | 4,029,716   | 3,714,565 |
| Debt:   |                               |             |             |             |           |
| ITC Holdings  | 1,689,619                     | 1,459,599   | 1,459,178   | 1,458,757   | 1,327,741 |
| Regulated Operating Subsidiaries                    | 1,457,608                     | 1,185,423   | 1,037,718   | 975,641     | 920,512   |
| Total debt  | 3,147,227                     | 2,645,022   | 2,496,896   | 2,434,398   | 2,248,253 |
| Total stockholders’ equity                          | \$1,414,855                   | \$1,258,892 | \$1,117,433 | \$1,011,523 | \$929,063 |



Table of Contents

| (In thousands)          | ITC Holdings and Subsidiaries |           |           |           |           |
|-------------------------|-------------------------------|-----------|-----------|-----------|-----------|
|                         | Year Ended December 31,       |           |           |           |           |
|                         | 2012                          | 2011      | 2010      | 2009      | 2008      |
| <b>CASH FLOWS DATA:</b> |                               |           |           |           |           |
| Capital expenditures    | \$802,763                     | \$556,931 | \$388,401 | \$404,514 | \$401,840 |

The reduction in expenses for 2009 were due, in part, to efforts to mitigate operation and maintenance expenses (a) and general and administrative expenses to offset the impact of lower network load on cash flows and any potential revenue accrual relating to 2009.

During 2011 and 2009, we recognized \$2.1 million and \$10.0 million, respectively of regulatory assets associated with the development activities of ITC Great Plains as well as certain pre-construction costs for the Kansas V-Plan and KETA projects. Upon initial establishment of these regulatory assets in 2011 and 2009, \$2.1 million and \$8.0 (b) million, respectively, of general and administrative expenses were reversed of which \$1.4 million and \$5.9 million were incurred in periods prior to 2011 and 2009, respectively. No initial establishment of regulatory assets occurred in 2010 that resulted in reversal of expenses.

During 2012 and 2011, we expensed external legal, advisory and financial services fees of \$19.4 million and \$7.0 (c) million, respectively relating to the proposed Entergy Transaction recorded within general and administrative expenses of which certain amounts are not expected to be deductible for income tax purposes.

In 2009, the FERC accepted the depreciation studies filed by ITCTransmission and METC that revised their depreciation rates. In 2010, the FERC accepted a depreciation study filed by ITC Midwest which (d) revised its depreciation rates. These changes in accounting estimates resulted in lower composite depreciation rates for ITCTransmission, METC and ITC Midwest primarily due to the revision of asset service lives and cost of removal values. The revised estimate of annual depreciation expense was reflected in 2009 for ITCTransmission and METC and in 2010 for ITC Midwest.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

### Safe Harbor Statement Under The Private Securities Litigation Reform Act of 1995

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

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

### Overview

Through our Regulated Operating Subsidiaries, we operate high-voltage systems in Michigan's Lower Peninsula and portions of Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma that transmit electricity from generating stations to local distribution facilities connected to our systems. Our business strategy is to operate, maintain and



Table of Contents

invest in transmission infrastructure in order to enhance system integrity and reliability, to reduce transmission constraints and to upgrade the transmission networks to support new generating resources interconnecting to our transmission systems. We also are pursuing development projects not within our existing systems, which are also intended to improve overall grid reliability, reduce transmission constraints and facilitate interconnections of new generating resources, as well as enhance competitive wholesale electricity markets.

As electric transmission utilities with rates regulated by the FERC, our Regulated Operating Subsidiaries earn revenues through tariff rates charged for the use of their electric transmission systems by our customers, which include investor-owned utilities, municipalities, cooperatives, power marketers and alternative energy suppliers. As independent transmission companies, our Regulated Operating Subsidiaries are subject to rate regulation only by the FERC. The rates charged by our Regulated Operating Subsidiaries are established using cost-based formula rate templates, as discussed in “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism.”

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

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

Significant recent matters that influenced our financial position and results of operations and cash flows for the year ended December 31, 2012 or may affect future results include:

- Our capital investment of \$819.8 million at our Regulated Operating Subsidiaries (\$231.2 million, \$149.0 million, \$343.3 million and \$96.3 million at ITCTransmission, METC, ITC Midwest and ITC Great Plains, respectively) for the year ended December 31, 2012, resulting primarily from our focus on improving system reliability, increasing system capacity and upgrading the transmission network to support new generating resources;

- Debt issuances and borrowings under our revolving and term loan credit agreements in 2012 and 2011 to fund capital investment at our Regulated Operating Subsidiaries, resulting in higher interest expense;

- Debt maturing within one year and the resulting additional financing required as discussed in Note 8 to the consolidated financial statements;

- Final recognition of revenues for the ITCTransmission rate freeze revenue deferral in May 2011, as discussed in “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism — ITCTransmission’s Rate Freeze Revenue Deferral”;

- The Entergy Transaction in which Entergy will divest and merge its electric transmission business with a wholly-owned subsidiary of ITC Holdings as discussed in “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Capital Project Updates and Other Recent Developments.” In 2012, we expensed external legal, advisory and financial services fees of \$19.4 million and internal labor costs of approximately \$7.1 million related to the Entergy Transaction primarily recorded within general and administrative expenses. Certain amounts of the external costs are not expected to be deductible for income tax purposes. The external and internal costs related to the Entergy Transaction are not included as components of revenue requirement as they were incurred at ITC Holdings. The transaction fees are expected to continue to be significant until the transaction is consummated. Completion of the transaction is anticipated to occur in 2013; and

- Recognition of the refund obligation at our MISO Regulated Operating Subsidiaries for the FERC audit of ITC Midwest, as discussed in Note 16 to the consolidated financial statements under “Commitments and Contingent Liabilities — FERC Audit of ITC Midwest.”

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



Table of Contents**Cost-Based Formula Rates with True-Up Mechanism**

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

**ITCTransmission's Rate Freeze Revenue Deferral**

ITCTransmission's rate freeze revenue deferral resulted from the difference between the revenue ITCTransmission would have collected under its cost based formula rate and the actual revenue ITCTransmission received for the period from February 28, 2003 through December 31, 2004. The rate freeze revenue deferral was amortized for ratemaking on a straight-line basis for five years from June 2006 through May 2011 and was included in ITCTransmission's revenue requirement for those periods. Revenues of \$5.0 million relating to the rate freeze revenue deferral were recognized in January through May 2011, which resulted in a reduction to after-tax net income of approximately \$3.2 million in 2012 compared to 2011.

**Revenue Accruals — Effects of Monthly Peak Loads**

For our MISO Regulated Operating Subsidiaries, monthly peak loads are used for billing network revenues, which currently is the largest component of our operating revenues. One of the primary factors that impacts the revenue accrual/deferral at our MISO Regulated Operating Subsidiaries is actual monthly peak loads experienced as compared to those forecasted in establishing the annual network transmission rate. Under their formula rates that contain a true-up mechanism, our Regulated Operating Subsidiaries accrue or defer revenues to the extent that their actual revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. For example, to the extent that amounts billed are less than the revenue requirement for a reporting period, a revenue accrual is recorded for the difference. To the extent that amounts billed are more than the revenue requirement for a reporting period, a revenue deferral is recorded for the difference. Although monthly peak loads do not impact operating revenues recognized, network load affects the timing of our cash flows from transmission service. The monthly peak load of our MISO Regulated Operating Subsidiaries is affected by many variables, but is generally impacted by weather and economic conditions and is seasonally shaped with higher load in the summer months when cooling demand is higher.

Table of Contents

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

Monthly Peak Load (in MW) (a)

|           | 2012                |        |                | 2011                |        |                | 2010                |        |                |
|-----------|---------------------|--------|----------------|---------------------|--------|----------------|---------------------|--------|----------------|
|           | ITC<br>Transmission | METC   | ITC<br>Midwest | ITC<br>Transmission | METC   | ITC<br>Midwest | ITC<br>Transmission | METC   | ITC<br>Midwest |
| January   | 7,264               | 6,145  | 2,789          | 7,326               | 6,045  | 2,777          | 7,255               | 5,947  | 2,838          |
| February  | 6,919               | 5,754  | 2,592          | 7,261               | 6,058  | 2,854          | 6,998               | 5,800  | 2,782          |
| March     | 6,941               | 5,708  | 2,443          | 6,946               | 5,715  | 2,520          | 6,620               | 5,376  | 2,517          |
| April     | 6,403               | 5,259  | 2,296          | 6,483               | 5,416  | 2,458          | 6,501               | 5,112  | 2,425          |
| May       | 8,947               | 6,459  | 2,700          | 10,119              | 7,239  | 2,773          | 9,412               | 7,240  | 3,052          |
| June      | 11,652              | 8,738  | 3,388          | 11,488              | 8,231  | 3,403          | 9,722               | 7,128  | 3,207          |
| July      | 12,222              | 9,358  | 3,643          | 12,321              | 9,389  | 3,621          | 11,451              | 8,498  | 3,422          |
| August    | 11,087              | 8,520  | 3,477          | 11,158              | 8,538  | 3,614          | 11,082              | 8,422  | 3,399          |
| September | 9,094               | 7,308  | 3,411          | 11,288              | 7,966  | 3,466          | 10,817              | 7,353  | 2,804          |
| October   | 6,626               | 5,428  | 2,487          | 6,642               | 5,479  | 2,559          | 6,725               | 5,414  | 2,447          |
| November  | 7,024               | 5,953  | 2,680          | 7,101               | 6,061  | 2,556          | 6,930               | 5,734  | 2,674          |
| December  | 7,226               | 5,891  | 2,682          | 7,206               | 6,071  | 2,734          | 7,824               | 6,526  | 2,928          |
| Total     | 101,405             | 80,521 | 34,588         | 105,339             | 82,208 | 35,335         | 101,337             | 78,550 | 34,495         |

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

The following table presents the network transmission rates (per kW/month) for our MISO Regulated Operating Subsidiaries as posted by MISO that are relevant to our cash flows since January 1, 2010:

| Network Transmission Rate            | ITC<br>Transmission | METC     | ITC<br>Midwest |
|--------------------------------------|---------------------|----------|----------------|
| January 1, 2010 to December 31, 2010 | \$2.818             | \$2.370  | \$6.882        |
| January 1, 2011 to December 31, 2011 | \$2.495             | \$2.331  | \$6.694        |
| January 1, 2012 to December 31, 2012 | \$2.188             | \$2.409  | \$6.797        |
| January 1, 2013 to December 31, 2013 | \$2.147             | \$2.5263 | \$7.805        |

ITC Great Plains does not receive revenue based on a peak load each month and therefore does not have a seasonal effect on operating cash flows. The SPP tariff applicable to ITC Great Plains is billed ratably each month based on its annual projected revenue requirement posted annually by SPP.

#### Revenue Requirement Calculation

Under their cost-based formula rate templates, each of our Regulated Operating Subsidiaries separately calculates a revenue requirement based on financial information specific to each company. The calculation of actual revenue requirements for a historic period is used to calculate the amount of network revenues recognized in that period and to calculate the true-up adjustment for that period. The calculation of projected revenue requirements is used to establish the transmission rate used for billing purposes, and follows the same methodology as the calculation of actual revenue requirement. The following steps illustrate the calculation of revenue requirement and the rate-setting methodology under the formula rate template with a true-up mechanism used by our MISO Regulated Operating Subsidiaries. ITC Great Plains follows a similar methodology and uses a FERC-approved return of 12.16% on the common equity portion of its capital structure.

#### Step One — Establish Projected Rate Base and Calculate Projected Allowed Return

Rate base is projected using the average of the projected month-end balances for the months beginning with December 31 of the current year and ending with December 31 of the upcoming year and consists primarily of projected in-service property, plant and equipment, net of accumulated depreciation, as well as other items.





Table of Contents

Projected rate base is multiplied by the projected weighted average cost of capital to determine the projected allowed return on rate base. The weighted average cost of capital is calculated using a projected 13-month average capital structure, the forecasted pre-tax cost of the debt portion of the capital structure and a FERC-approved return of 13.88%, 13.38%, and 12.38% for ITCTransmission, METC, and, ITC Midwest, respectively, on the common equity portion of the capital structure.

**Step Two — Calculate Projected Gross Revenue Requirement**

The projected gross revenue requirement is calculated beginning with the projected allowed return on rate base, as calculated in Step One above, and adding projected recoverable operating expenses and an allowance for income taxes, depreciation and amortization.

**Step Three — Calculate Projected Revenue Requirement**

After calculating the projected gross revenue requirement in Step Two above, the 2013 projected gross revenue requirement is adjusted for any 2011 true-up adjustment and is reduced for certain revenues received other than network revenues, such as projected point-to-point, regional cost sharing revenues and rental revenues to arrive at our projected revenue requirement.

**Illustration of Formula Rate Setting**

Set forth below is a simplified illustration of the calculation of ITCTransmission's projected revenue requirement as well as its component of the joint zone network transmission rate for billing purposes under its formula rate setting mechanism for the period from January 1, 2013 through December 31, 2013, that was based primarily upon projections of ITCTransmission's 2013 FERC Form No. 1 data. Amounts below are approximations of the amounts used to establish ITCTransmission's 2013 projected revenue requirement.

| Line | Item  | Instructions                   | Amount          |
|------|---|--------------------------------|-----------------|
| 1    | Projected rate base   |                                | \$1,162,323,000 |
| 2    | Multiply by projected 13-month weighted average cost of capital (a)             |                                | 10.25 %         |
| 3    | Projected allowed return on rate base   | (Line 1 x Line 2)              | \$119,138,108   |
| 4    | Projected recoverable operating expenses for 2013                               |                                | \$60,585,000    |
| 5    | Projected taxes and depreciation and amortization for 2013                      |                                | \$141,022,000   |
| 6    | Projected gross revenue requirements for 2013                                   | (Line 3 + Line 4 + Line 5)     | \$320,745,108   |
| 7    | Less projected revenue credits for 2013   |                                | \$(74,481,000 ) |
| 8    | Plus/(less) 2011 true-up adjustment   |                                | \$(25,537,000 ) |
| 9    | Projected revenue requirement for 2013  | (Line 6 + Line 7 + Line 8)     | \$220,727,108   |
| 10   | Projected average monthly 2013 network load (in kW)                             |                                | 8,567,000       |
| 11   | Annual component of the joint zone network transmission rate                    | (Line 9 divided by Line 10)    | \$25.765        |
| 12   | Monthly component of the joint zone network transmission rate (\$/kW per month) | (Line 11 divided by 12 months) | \$2.147         |

(a) The weighted average cost of capital for purposes of this illustration is calculated as follows:

|        | Percentage of<br>ITC Transmission's<br>Total Capitalization | Cost of Capital      | Weighted<br>Average<br>Cost of<br>Capital |   |
|--------|---|----------------------|---|---|
| Debt   | 40.00%  | 4.80% (Pre-tax) =    | 1.92                                      | % |
| Equity | 60.00%  | 13.88% (After tax) = | 8.33                                      | % |
|        | 100.00%   |                      | 10.25                                     | % |

#### Capital Investment and Operating Results Trends

We expect a general trend of increases in revenues and earnings for our Regulated Operating Subsidiaries over the long term. The primary factor that is expected to continue to increase our actual revenue requirements in future years is our anticipated capital investment in excess of depreciation as a result of our Regulated Operating Subsidiaries' long-term capital investment programs to improve reliability, increase system capacity and upgrade the transmission network to support new generating resources, as well as the Entergy Transaction. In addition,

Table of Contents

our capital investment efforts relating to development initiatives are based on establishing an ongoing pipeline of projects that will position us for long-term growth. Investments in property, plant and equipment, when placed in service upon completion of a capital project, are added to the rate base of our Regulated Operating Subsidiaries. Our Regulated Operating Subsidiaries strive for high reliability of their systems and to improve system accessibility for all generation resources. Effective June 2007, the FERC approved mandatory adoption of certain reliability standards and approved enforcement actions for violators, including fines of up to \$1.0 million per day. The NERC was assigned the responsibility of developing and enforcing these mandatory reliability standards. We continually assess our transmission systems against standards established by the NERC, as well as the standards of applicable regional entities under the NERC that have been delegated certain authority for the purpose of proposing and enforcing reliability standards. We believe we meet the applicable standards in all material respects, although further investment in our transmission systems and an increase in maintenance activities will likely be needed to maintain compliance, improve reliability and address any new standards that may be promulgated.

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

| Source of Investment<br>(In millions) | Long-term Capital<br>Investment Program<br>2012-2016 (a) | Actual Capital<br>Investment for the<br>Year Ended<br>December 31, 2012 (b) | Forecasted Capital<br>Investment for the<br>Year Ending<br>December 31, 2013 (a) |
|---------------------------------------|--|---|--|
| ITC Transmission                      | \$739  | \$231.2   | \$200 — 230  |
| METC                                  | 581  | 149.0   | 160 — 180  |
| ITC Midwest                           | 1,128  | 343.3   | 270 — 300  |
| ITC Great Plains (c)                  | 343  | 96.3  | 130 — 150  |
| Development (d)                       | 1,390  | —   | —  |
| Total                                 | \$4,181  | \$819.8   | \$760 — 860  |

The current long-term capital investment program does not include anticipated expenditures related to the Entergy (a) Transaction. The investments in property, plant and equipment would be expected to increase significantly upon closing of that transaction.

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

ITC Great Plains' investment program includes the Kansas V-Plan Project that is under construction in addition to (c) the KETA and Hugo-to-Valliant projects which were completed and placed in-service in 2012.

The long-term capital investment program includes expenditures to construct various development projects such as (d) our portions of the four MISO MVPs.

Investments in property, plant and equipment could vary due to, among other things, the impact of actual loads, forecasted loads, regional economic conditions, weather conditions, union strikes, labor shortages, material and equipment prices and availability, our ability to obtain financing for such expenditures, if necessary, limitations on the amount of construction that can be undertaken on our systems at any one time, regulatory approvals for reasons relating to rate construct, environmental, siting, regional planning, cost recovery or other issues or as a result of legal proceedings and variances between estimated and actual costs of construction contracts awarded. In addition,

investments in transmission network upgrades for generator interconnection projects could change from prior estimates significantly due to changes in the MISO queue for generation projects, the generator's potential failure

## Table of Contents

to meet the various criteria of Attachment FF of the MISO tariff for the project to qualify as a refundable network upgrade, and other factors beyond our control.

### Capital Project Updates and Other Recent Developments

#### Thumb Loop Project

The Thumb Loop Project is located in ITC Transmission's region and consists of a 140-mile, double-circuit 345 kV transmission line and related substations that will serve as the backbone of the transmission system needed to accommodate future wind development projects in the Michigan counties of Tuscola, Huron, Sanilac and St. Clair. Construction activities commenced for the Thumb Loop Project in 2012. Through December 31, 2012, ITC Transmission has invested \$173.5 million in the Thumb Loop Project. We estimate ITC Transmission will invest a total of approximately \$510 million to complete construction of the project.

#### ITC Great Plains

##### KETA Project

The KETA Project is a 225-mile transmission line that runs between Spearville, Kansas and Axtell, Nebraska. The portion of the transmission line that ITC Great Plains was responsible for constructing runs approximately 174 miles. The KETA Project was placed in-service in 2012.

##### Kansas V-Plan Project

The Kansas V-Plan Project is a 200-mile transmission line that will run between Spearville and Wichita, Kansas. ITC Great Plains is responsible for constructing an approximately 120 mile portion of the project from Spearville to Medicine Lodge, Kansas. ITC Great Plains commenced construction during 2012, and through December 31, 2012, ITC Great Plains has invested \$37.4 million in the Kansas V-Plan Project. We estimate that ITC Great Plains will invest a total of approximately \$300 million to complete construction of its portion of the project.

#### Regulatory Assets

As of December 31, 2012, we have recorded approximately \$14.1 million of regulatory assets for start-up and development expenses incurred by ITC Great Plains, which include certain costs incurred for the KETA Project and the Kansas V-Plan Project prior to construction. In March 2011, we recognized a regulatory asset for the Kansas V-Plan Project of \$2.0 million and a corresponding reduction to operating expenses, which increased net income by \$1.3 million. Subsequent to the initial recognition of the Kansas V-Plan Project regulatory asset in March 2011, we recorded costs incurred for the Kansas V-Plan Project directly to this regulatory asset. 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.

#### Development Bonuses

During 2012 and 2011, we recognized general and administrative expenses of \$2.9 million and \$1.2 million, respectively, for bonuses for the successful completion of certain milestones relating to projects at ITC Great Plains. It is reasonably possible that future development-related bonuses would be authorized and awarded for these or other development projects.

#### North Central Region Development

In 2009, we announced the Green Power Express project, which consisted of transmission line segments that would facilitate the movement of power from the Dakotas, Minnesota and Iowa to Midwest load centers that demand energy. After the announcement of the Green Power Express project, MISO undertook RGOS to promote investments in new regional transmission infrastructure and implemented its MVP cost allocation methodology. MISO's RGOS and MVP processes provide a channel for the Green Power Express project, or its underlying segments, to move forward through the planning approval process as MVPs. In December 2011, MISO approved the first portfolio of MVPs identified through the RGOS which includes portions of four MVPs that we intend to build, own and operate. The four MVPs are located in south central Minnesota, portions of Iowa, southwest Wisconsin, and northeast Missouri. We continue to explore other opportunities to advance segments of our Green Power Express project, or similar RGOS projects, through the MISO MVP process.



## Table of Contents

### Entergy Transaction

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

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

The terms of the transaction agreements call for Entergy to divest its electric transmission business to a newly-formed entity, Mid South TransCo LLC (“Mid South TransCo”), and Mid South TransCo’s subsidiaries, and distribute the equity interests in Mid South TransCo to Entergy’s shareholders in the form of a tax-free spin-off. 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 closing the merger, we expect to effectuate a \$700 million 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. This indebtedness will be assumed by us upon completion of the transaction.

Completion of the Entergy Transaction is expected in 2013 and is subject to the satisfaction of certain closing conditions, including receipt of the necessary approvals of Entergy’s retail regulators, the FERC and ITC Holdings’ shareholders. There can be no assurance the Entergy Transaction will be consummated. See “Item 1A Risk Factors — We may be unable to satisfy the conditions or obtain the approvals required to complete the Entergy Transaction or such approvals may contain material restrictions or conditions.”

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 for the foreseeable future.

### Significant Components of Results of Operations

#### Revenues

We derive nearly all of our revenues from providing network transmission service, point-to-point transmission service and other related services over our Regulated Operating Subsidiaries’ transmission systems to Detroit Edison, Consumers Energy, IP&L and to other entities such as alternative electricity suppliers, power marketers and other wholesale customers that provide electricity to end-use consumers and from transaction-based capacity reservations on our transmission systems. MISO and SPP are responsible for billing and collection of transmission services. As the billing agent for our Regulated Operating Subsidiaries, MISO and SPP collect fees for the use of our transmission systems, invoicing Detroit Edison, Consumers Energy, IP&L and other customers on a monthly basis.

Network Revenues are generated from network customers for their use of our electric transmission systems and consist of both billed network revenues and accrued or deferred revenues as a result of our accounting under our cost-based formula rates that contain a true-up mechanism. Refer to “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies — Revenue Recognition under Cost-Based Formula Rates with True-Up Mechanisms” for a discussion of revenue recognition relating to network revenues. The monthly network revenues billed to customers using the transmission facilities of our MISO Regulated Operating Subsidiaries are the result of a calculation which can be simplified into the following:





Table of Contents

- (1) multiply the network load measured in kW achieved during the one hour of monthly peak usage for our transmission systems by the appropriate monthly tariff rate by 12 by the number of days in that month; and
- (2) divide the result by 365.

Network revenues from ITC Great Plains include the annual revenue requirements specific to projects that are charged exclusively within one pricing zone within SPP or are classified as direct assigned network upgrades under the SPP tariff and contain a true-up mechanism. Our annual projected project revenue requirements at ITC Great Plains are billed ratably each month and therefore peak usage does not impact its billed network transmission revenues.

Point-to-Point Revenues consist of revenues generated from a type of transmission service for which the customer pays for transmission capacity reserved along a specified path between two points on an hourly, daily, weekly or monthly basis. Point-to-point revenues also include other components pursuant to schedules under the MISO and SPP transmission tariffs. Point-to-point revenues are a reduction to gross revenue requirement when calculating net revenue requirement under our cost-based formula rates.

Regional Cost Sharing Revenues are generated from transmission customers throughout RTO regions for their use of our MISO Regulated Operating Subsidiaries' network upgrade projects that are eligible for regional cost sharing under provisions of the MISO tariff, including MVP projects such as the Thumb Loop Project. Regional cost sharing revenue also includes revenues collected by transmission customers from other RTOs outside of MISO to allocate costs of certain transmission plant investments. Additionally, the KETA Project and Kansas V-Plan Project at ITC Great Plains are eligible for recovery through a region-wide charge under provisions of the SPP tariff. Regional cost sharing revenues consist of both billed regional cost sharing revenues and accrued or deferred revenues as a result of our accounting under our cost-based formula rates that contain a true-up mechanism. The amount of the regional cost sharing revenue accruals (deferrals) is estimated for each reporting period until such time as the regional cost sharing formula rate templates based on actual costs are completed for each of our Regulated Operating Subsidiaries during the following year. A portion of regional costs sharing revenues are not subject to a direct true-up but instead are treated as reduction to either our regional or network gross revenue requirement when calculating net revenue requirement.

Scheduling, Control and Dispatch Revenues are allocated to our MISO Regulated Operating Subsidiaries by MISO as compensation for the services performed in operating the transmission system. Such services include monitoring of reliability data, current and next day analysis, implementation of emergency procedures and outage coordination and switching. Beginning in 2013, certain scheduling, control and dispatch revenues will include a true-up adjustment at our MISO Regulated Operating Subsidiaries which ensures that our MISO Regulated Operating Subsidiaries recover their allowed costs.

Other Revenues consist of rental revenues, easement revenues, revenues relating to utilization of jointly owned lines under our transmission ownership and operating agreements and amounts from providing ancillary services to customers. The majority of other revenues are a reduction to gross revenue requirement when calculating net revenue requirement under our cost-based formula rates.

**Operating Expenses**

Operation and Maintenance Expenses consist primarily of the costs of contractors to operate and maintain our transmission systems and costs for our personnel involved in operation and maintenance activities.

Operation expenses include activities related to control area operations, which involve balancing loads and generation and transmission system operations activities, including monitoring the status of our transmission lines and stations. The expenses relating to METC's Easement Agreement are also recorded within operation expenses.

Maintenance expenses include preventive or planned maintenance, such as vegetation management, tower painting and equipment inspections, as well as reactive maintenance for equipment failures.

General and Administrative Expenses consist primarily of costs for personnel in our legal, information technology, finance, regulatory and human resources organizations, general office expenses and fees for professional services.

Professional services are principally composed of outside legal, audit and information technology services.

Professional advisory and consulting services primarily related to external legal, advisory and financial services fees related to the Entergy Transaction are included in general and administrative expenses.



Table of Contents

We capitalize to property, plant and equipment portions of certain general and administrative expenses such as compensation, office rent, utilities and information technology.

Depreciation and Amortization Expenses consist primarily of depreciation of property, plant and equipment using the straight-line method of accounting. Additionally, this consists of amortization of various regulatory and intangible assets. We capitalize to property, plant and equipment depreciation expense for vehicles and equipment used in our construction activities.

Taxes other than Income Taxes consist primarily of property taxes and payroll taxes.

Other items of income or expense

Interest Expense consists primarily of interest on debt at ITC Holdings and our Regulated Operating Subsidiaries. Additionally, the amortization of debt financing expenses is recorded to interest expense. An allowance for borrowed funds used during construction is included in property, plant and equipment accounts and is a reduction to interest expense.

Allowance for Equity Funds Used During Construction (“AFUDC equity”) is recorded as an item of other income and is included in property, plant and equipment accounts. The allowance represents a return on equity at our Regulated Operating Subsidiaries used for construction purposes in accordance with FERC regulations. The capitalization rate applied to the construction work in progress balance is based on the proportion of equity to total capital (which currently includes equity and long-term debt) and the allowed return on equity for our Regulated Operating Subsidiaries.

Income tax provision

Income tax provision consists of federal and state income taxes.

Results of Operations

The following table summarizes historical operating results for the periods indicated:

|   | Year Ended   |            | Percentage |            | Year ended   |            | Percentage |  |
|---|--------------|------------|------------|------------|--------------|------------|------------|--|
|   | December 31, |            | Increase   | Increase   | December 31, | Increase   | Increase   |  |
| (In thousands)                                      | 2012         | 2011       | (Decrease) | (Decrease) | 2010         | (Decrease) | (Decrease) |  |
| <b>OPERATING REVENUES</b>                           | \$830,535    | \$757,397  | \$ 73,138  | 9.7%       | \$696,843    | \$ 60,554  | 8.7%       |  |
| <b>OPERATING EXPENSES</b>                           |              |            |            |            |              |            |            |  |
| Operation and maintenance                           | 121,941      | 129,288    | (7,347 )   | (5.7)%     | 126,528      | 2,760      | 2.2%       |  |
| General and administrative                          | 112,091      | 82,790     | 29,301     | 35.4%      | 78,120       | 4,670      | 6.0%       |  |
| Depreciation and amortization                       | 106,512      | 94,981     | 11,531     | 12.1%      | 86,976       | 8,005      | 9.2%       |  |
| Taxes other than income taxes                       | 59,701       | 53,430     | 6,271      | 11.7%      | 48,195       | 5,235      | 10.9%      |  |
| Other operating (income) and expenses — net         | (769 )       | (844 )     | 75         | (8.9)%     | (297 )       | (547 )     | 184.2%     |  |
| Total operating expenses                            | 399,476      | 359,645    | 39,831     | 11.1%      | 339,522      | 20,123     | 5.9%       |  |
| <b>OPERATING INCOME</b>                             | 431,059      | 397,752    | 33,307     | 8.4%       | 357,321      | 40,431     | 11.3%      |  |
| <b>OTHER EXPENSES (INCOME)</b>                      |              |            |            |            |              |            |            |  |
| Interest expense                                    | 155,734      | 146,936    | 8,798      | 6.0%       | 142,553      | 4,383      | 3.1%       |  |
| Allowance for equity funds used during construction | (23,000 )    | (16,699 )  | (6,301 )   | 37.7%      | (13,412 )    | (3,287 )   | 24.5%      |  |
| Other income  | (2,401 )     | (2,881 )   | 480        | (16.7)%    | (2,340 )     | (541 )     | 23.1%      |  |
| Other expense                                       | 4,218        | 3,962      | 256        | 6.5%       | 2,588        | 1,374      | 53.1%      |  |
| Total other expenses (income)                       | 134,551      | 131,318    | 3,233      | 2.5%       | 129,389      | 1,929      | 1.5%       |  |
| <b>INCOME BEFORE INCOME TAXES</b>                   | 296,508      | 266,434    | 30,074     | 11.3%      | 227,932      | 38,502     | 16.9%      |  |
| <b>INCOME TAX PROVISION</b>                         | 108,632      | 94,749     | 13,883     | 14.7%      | 82,254       | 12,495     | 15.2%      |  |
| <b>NET INCOME</b>                                   | \$ 187,876   | \$ 171,685 | \$ 16,191  | 9.4%       | \$ 145,678   | \$ 26,007  | 17.9%      |  |



Table of Contents

## Operating Revenues

Year ended December 31, 2012 compared to year ended December 31, 2011

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

| (In thousands)                   | 2012      |            | 2011        |            | Increase<br>(Decrease) | Percentage<br>Increase<br>(Decrease) |   |
|----------------------------------|-----------|------------|-------------|------------|------------------------|--------------------------------------|---|
|                                  | Amount    | Percentage | Amount      | Percentage |                        |                                      |   |
| Network revenues                 | \$669,048 | 80.6       | % \$637,807 | 84.2       | % \$31,241             | 4.9                                  | % |
| Regional cost sharing revenues   | 122,626   | 14.8       | % 87,304    | 11.5       | % 35,322               | 40.5                                 | % |
| Point-to-point                   | 17,439    | 2.1        | % 15,903    | 2.1        | % 1,536                | 9.7                                  | % |
| Scheduling, control and dispatch | 15,077    | 1.8        | % 11,583    | 1.5        | % 3,494                | 30.2                                 | % |
| Other                            | 6,345     | 0.7        | % 4,800     | 0.7        | % 1,545                | 32.2                                 | % |
| Total                            | \$830,535 | 100.0      | % \$757,397 | 100.0      | % \$73,138             | 9.7                                  | % |

Network revenues increased due primarily to higher net revenue requirements at our Regulated Operating Subsidiaries during the year ended December 31, 2012 as compared to the same period in 2011. Higher net revenue requirements were due primarily to higher rate base associated with higher balances of property, plant and equipment in-service and higher recoverable expenses due to higher operating expenses, partially offset by the final monthly recognition in January through May 2011 of the ITC Transmission rate freeze revenue deferral described above under “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism — ITC Transmission’s Rate Freeze Revenue Deferral” and the recognition of the FERC refund totaling \$11.0 million during the second quarter of 2012 as discussed in Note 16 to the consolidated financial statements under “Commitments and Contingent Liabilities — FERC Audit of ITC Midwest.”

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

Point-to-point revenues increased due primarily to an increase in the number of point-to-point reservations.

Scheduling, control and dispatch revenues increased due primarily to a change in MISO’s revenue distribution methodology for these types of revenues in 2012 compared to 2011. The new method was implemented by MISO in 2012 to better align the billing rates relating to these services with the projected expenses.

Operating revenues for the year ended December 31, 2012 include the network revenue accruals (deferrals) and regional cost sharing revenue accruals (deferrals) as calculated below:

| Line           | Item  | ITC Transmission | METC        | ITC Midwest | ITC Great Plains | Total Net Revenue Deferrals |
|----------------|---|------------------|-------------|-------------|------------------|-----------------------------|
| (In thousands) |   |                  |             |             |                  |                             |
| 1              | Estimated net revenue requirement (network revenues recognized) (a) | \$239,952        | \$199,648   | \$236,938   | \$3,482          |                             |
| 2              | Network revenues billed (b)   | 251,501          | 197,662     | 239,637     | 4,630            |                             |
| 3              | Network revenue accruals (deferrals) (line 1 — line 2)              | (11,549)         | ) 1,986     | (2,699)     | ) (1,148)        | )                           |
| 4              | Regional cost sharing revenue accruals (deferrals) (c)              | (1,393)          | ) (5,766)   | ) 957       | (5,254)          | )                           |
| 5              | Total net revenue deferrals (line 3 + line 4)                       | \$(12,942)       | ) \$(3,780) | ) \$(1,742) | ) \$(6,402)      | ) \$(24,866)                |

(a) The calculation of the net revenue requirement for our Regulated Operating Subsidiaries is described in “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism — Net Revenue Requirement Calculation.” The amount is estimated for each

reporting period until such time as FERC Form No. 1's are completed for our Regulated Operating Subsidiaries.

Table of Contents

The refund totaling \$11.0 million recognized during the second quarter of 2012 as discussed in Note 16 to the consolidated financial statements under “Commitments and Contingent Liabilities — FERC Audit of ITC Midwest” is not included as a reduction in the estimated net revenue requirement above. We have separately recorded a regulatory liability for this refund.

Network revenues billed at our MISO Regulated Operating Subsidiaries are calculated based on the joint zone monthly network peak load multiplied by their effective monthly network rates for 2012 of \$2.188 per kW/month, \$2.409 per kW/month and \$6.797 per kW/month applicable to ITCTransmission, METC and ITC Midwest, respectively, adjusted for the actual number of days in the month less amounts recovered or refunded associated with our MISO Regulated Operating Subsidiaries 2010 true-up adjustments. The rates for 2012 include amounts for the collection and refund of the 2010 revenue accruals and deferrals and related accrued interest and the (b) revenues billed in 2012 associated with the 2010 revenue accruals and deferrals are not included in these amounts.

On August 31, 2012, ITCTransmission’s projected network rate of \$2.147 per kW/month, METC’s projected network rate of \$2.5263 per kW/month and ITC Midwest’s projected network rate of \$7.805 per kW/month, in each case for the period from January 1, 2013 through December 31, 2013, were posted by MISO. Our rates at ITC Great Plains are billed ratably each month based on its annual projected net revenue requirement. ITC Great Plains’ projected revenue requirement of \$44.2 million for the period from January 1, 2013 through December 31, 2013 was posted by SPP on August 31, 2012.

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

Year ended December 31, 2011 compared to year ended December 31, 2010

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

| (In thousands)                   | 2011      |            | 2010        |            | Increase<br>(Decrease) | Percentage<br>(Decrease) |
|----------------------------------|-----------|------------|-------------|------------|------------------------|--------------------------|
|                                  | Amount    | Percentage | Amount      | Percentage |                        |                          |
| Network revenues                 | \$637,807 | 84.2       | % \$595,071 | 85.4       | % \$42,736             | 7.2 %                    |
| Regional cost sharing revenues   | 87,304    | 11.5       | % 55,638    | 8.0        | % 31,666               | 56.9 %                   |
| Point-to-point                   | 15,903    | 2.1        | % 26,063    | 3.7        | % (10,160 )            | (39.0 )%                 |
| Scheduling, control and dispatch | 11,583    | 1.5        | % 14,525    | 2.1        | % (2,942 )             | (20.3 )%                 |
| Other                            | 4,800     | 0.7        | % 5,546     | 0.8        | % (746 )               | (13.5 )%                 |
| Total                            | \$757,397 | 100.0      | % \$696,843 | 100.0      | % \$60,554             | 8.7 %                    |

Network revenues increased due primarily to higher net revenue requirements at our Regulated Operating Subsidiaries during the year ended December 31, 2011 as compared to the same period in 2010. Higher net revenue requirements were due primarily to higher rate base associated with higher balances of property, plant and equipment in-service and higher recoverable expenses due to higher operating expenses, partially offset by the final monthly recognition in May 2011 of the ITCTransmission rate freeze revenue deferral described above under “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism — ITCTransmission’s Rate Freeze Revenue Deferral.”

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

Point-to-point revenues decreased due primarily to a decline in the number of point-to-point reservations.

Scheduling, control and dispatch revenues decreased due primarily to a change in MISO’s revenue distribution methodology for these types of revenues in 2011 compared to 2010.





Table of Contents

Operating revenues for the year ended December 31, 2011 include the network revenue accruals (deferrals) and regional cost sharing revenue accruals (deferrals) as calculated below:

| Line           | Item  | ITCTransmission | METC        | ITC<br>Midwest | ITC Great<br>Plains | Total<br>Net Revenue<br>Deferrals |
|----------------|---|-----------------|-------------|----------------|---------------------|-----------------------------------|
| (In thousands) |   |                 |             |                |                     |                                   |
| 1              | Estimated net revenue requirement (network revenues recognized) (a) | \$243,917       | \$188,577   | \$203,083      | \$2,230             |                                   |
| 2              | Network revenues billed (b)   | 267,842         | 198,110     | 212,778        | 718                 |                                   |
| 3              | Network revenue accruals (deferrals) (line 1 — line 2)              | (23,925 )       | (9,533 )    | (9,695 )       | 1,512               |                                   |
| 4              | Regional cost sharing revenue accruals (deferrals) (c)              | (1,637 )        | (1,237 )    | 4,088          | (3,322 )            |                                   |
| 5              | Total net revenue deferrals (line 3 + line 4)                       | \$(25,562 )     | \$(10,770 ) | \$(5,607 )     | \$(1,810 )          | \$(43,749 )                       |

The calculation of net revenue requirement for our Regulated Operating Subsidiaries is described in “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism — Net Revenue Requirement Calculation.” The amount is estimated for each reporting period until such time as FERC Form No. 1’s are completed for our Regulated Operating Subsidiaries. Network revenues billed at our MISO Regulated Operating Subsidiaries are calculated based on the joint zone monthly network peak load multiplied by their effective monthly network rates for 2011 of \$2.495 per kW/month, \$2.331 per kW/month and \$6.694 per kW/month applicable to ITCTransmission, METC and ITC Midwest, respectively, adjusted for the actual number of days in the month less amounts recovered or refunded associated with our MISO Regulated Operating Subsidiaries 2009 true-up adjustments. The rates for 2011 include amounts for the collection and refund of the 2009 revenue accruals and deferrals and related accrued interest and the revenues billed in 2011 associated with the 2009 revenue accruals and deferrals are not included in these amounts. Our rates at ITC Great Plains are billed ratably each month based on its annual projected net revenue requirement. Regional cost sharing revenues are subject to a separate true-up mechanism whereby our Regulated Operating Subsidiaries accrue or defer revenues for any over- or under-recovery. The related revenue accruals or deferrals associated with regional cost sharing revenues are included in the regional cost sharing revenue amounts.

#### Operating Expenses

##### Operation and maintenance expenses

Year ended December 31, 2012 compared to year ended December 31, 2011

Operation and maintenance expenses decreased by \$2.5 million due to increased cost efficiencies associated primarily with substation, breaker and relay maintenance activities, partially offset by higher vegetation management activities, \$2.2 million due to a decrease in activities associated with surveying transmission overhead lines and \$1.2 million due to lower operating and training expenses.

Year ended December 31, 2011 compared to year ended December 31, 2010

Operation and maintenance expenses increased by \$4.8 million due to NERC compliance activities associated with surveying transmission overhead lines, by \$3.0 million due to higher vehicles and equipment expenses related to higher fuel costs as well as the age and number of vehicles in the fleet, by \$2.6 million due to higher operating and training expenses, and by \$2.5 million due to higher costs of helicopter patrolling for infrared and visual inspections of the system and transmission lines. These increases were partially offset by \$4.5 million due to lower vegetation management requirements, \$3.0 million due to lower substation facility maintenance expenses, and \$3.0 million due to reduced structure maintenance primarily caused by reduced tower painting requirement in 2011.



Table of Contents

General and administrative expenses

Year ended December 31, 2012 compared to year ended December 31, 2011

General and administrative expenses increased due to legal, advisory and financial services fees for the Entergy Transaction of \$12.3 million, higher compensation-related expense of \$8.7 million primarily due to personnel increases and increases in bonuses earned in 2012 such as those described above under “Capital Project Updates and Other Recent Developments — Development Bonuses”, \$2.6 million due to general business expenses primarily due to information technology support, \$2.1 million due to the recognition of the Kansas V-Plan Project regulatory asset which reduced expenses in 2011 and did not occur in 2012, \$2.1 million due to an increase in other professional services such as legal, advisory and financial services fees and \$1.4 million due to increases in general facilities expenses.

Year ended December 31, 2011 compared to year ended December 31, 2010

General and administrative expenses increased by \$7.2 million due to higher professional advisory and consulting services primarily related to external legal, advisory and financial services fees related to the Entergy Transaction and by \$2.1 million due to higher general business expenses primarily due to increased information technology support. These increases were partially offset by \$3.6 million of lower compensation-related expenses and by the reduction of expenses in the first quarter of 2011 of \$2.1 million (of which \$1.4 million were incurred in periods prior to 2011) in connection with the recognition of the Kansas V-Plan Project regulatory asset.

Depreciation and amortization expenses

Year ended December 31, 2012 compared to year ended December 31, 2011

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

Year ended December 31, 2011 compared to year ended December 31, 2010

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

Taxes other than income taxes

Year ended December 31, 2012 compared to year ended December 31, 2011

Taxes other than income taxes increased due to higher property tax expenses primarily due to our MISO Regulated Operating Subsidiaries’ 2011 capital additions, which are included in the assessments for 2012 property taxes.

Year ended December 31, 2011 compared to year ended December 31, 2010

Taxes other than income taxes increased due to higher property tax expenses primarily due to our MISO Regulated Operating Subsidiaries’ 2010 capital additions, which are included in the assessments for 2011 property taxes.

Other expenses (income)

Year ended December 31, 2012 compared to year ended December 31, 2011

Interest expense increased due primarily to an increase in borrowing levels under our revolving and term loan credit agreements.

Year ended December 31, 2011 compared to year ended December 31, 2010

Interest expense increased due primarily to an increase in borrowing levels under our revolving credit agreements.

Income Tax Provision

Year ended December 31, 2012 compared to year ended December 31, 2011

Our effective tax rates for the years ended December 31, 2012 and 2011 are 36.6% and 35.6%, respectively. Our effective tax rate differs from our 35% statutory federal income tax rate due primarily to state income taxes as well as the tax effects of AFUDC equity which reduced the effective tax rate. The amount of income tax expense

Table of Contents

relating to AFUDC equity is recognized as a regulatory asset and not included in the income tax provision. We recorded a state income tax provision of \$6.2 million (net of federal deductibility) during the year ended December 31, 2012, compared to a state income tax provision of \$3.8 million (net of federal deductibility) for the year ended December 31, 2011. Included in the state income tax provision recorded during the year ended December 31, 2011 is the effect of the Michigan tax law change as discussed in Note 10, which reduced the income tax provision by \$4.6 million.

Year ended December 31, 2011 compared to year ended December 31, 2010

Our effective tax rates for the years ended December 31, 2011 and 2010 are 35.6% and 36.1%, respectively. Our effective tax rate differs from our 35% statutory federal income tax rate due primarily to state income taxes as well as the tax effects of AFUDC equity which reduced the effective tax rate. The amount of income tax expense relating to AFUDC equity is recognized as a regulatory asset and not included in the income tax provision. We recorded a state income tax provision of \$3.8 million (net of federal deductibility) during the year ended December 31, 2011, compared to a state income tax provision of \$5.9 million (net of federal deductibility) for the year ended December 31, 2010. Included in the state income tax provision recorded during the year ended December 31, 2011 is the effect of the Michigan tax law change as discussed in Note 10, which reduced the income tax provision by \$4.6 million.

Liquidity and Capital Resources

We expect to fund our future capital requirements with cash from operations, our existing cash and cash equivalents and amounts available under our revolving and term loan credit agreements (the terms of which are described in Note 8 to the consolidated financial statements). In addition, we may from time to time secure debt and equity funding in the capital markets, although we can provide no assurance that we will be able to obtain financing on favorable terms or at all. We expect that our capital requirements will arise principally from our need to:

- Fund capital expenditures at our Regulated Operating Subsidiaries and, following the close of the Entergy Transaction, capital expenditures at the subsidiaries of Mid South TransCo. Our plans with regard to property, plant and equipment investments are described in detail above under “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Capital Investment and Operating Results Trends.”

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

- Fund working capital requirements.

- Fund our debt service requirements, which are described in detail below under “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Contractual Obligations.” We expect our interest payments to increase each year as a result of the additional debt we expect to incur to fund our capital expenditures.

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

- Fund contributions to our retirement plans, as described in Note 11 to the consolidated financial statements. We expect to contribute up to \$12.4 million to these plans in 2013. The impact of the growth in the number of participants in our retirement benefit plans and changes in the requirements of the Pension Protection Act may require contributions to our retirement plans to be higher than we have experienced in the past.

In addition to the expected capital requirements above, any adverse determinations relating to the contingencies described in Note 16 to the consolidated financial statements would result in additional capital requirements.

We believe that we have sufficient capital resources to meet our currently anticipated short-term needs. We rely on both internal and external sources of liquidity to provide working capital and to fund capital investments. We expect to continue to utilize our revolving and term loan credit agreements and our cash and cash equivalents as needed to meet our short-term cash requirements. As described in Note 8 to the consolidated financial statements, in 2012, we entered into a new revolving credit agreement at ITC Midwest for \$175.0 million and a new term loan credit agreement for \$200.0 million at ITC Holdings. The new revolving and term loan credit



Table of Contents

agreements increased our borrowing capacity by \$259.0 million. During 2011, we entered into new revolving credit agreements at ITC Holdings, ITC Great Plains, ITCTransmission and METC in the amount of \$200.0 million, \$150.0 million, \$100.0 million and \$100.0 million, respectively. As of December 31, 2012, we had consolidated indebtedness under our revolving and term loan credit agreements of \$527.8 million, with unused capacity under the agreements of \$397.2 million.

We have approximately \$652.0 million of debt maturing during 2013 at ITC Holdings and ITCTransmission. The maturing debt is expected to be refinanced with short and long-term debt. In addition, for our long-term capital requirements and the funding of the anticipated \$700 million recapitalization in connection with the Entergy Transaction, we expect that we will need to obtain additional debt financing. Certain of our capital projects could be delayed in the event we experience difficulties in accessing capital. We expect to be able to obtain such additional financing for both our short and long-term requirements as needed, in amounts and upon terms that will be reasonably satisfactory to us due to our strong credit ratings and our historical ability to obtain financing.

Credit Ratings

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

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

(a) On December 19, 2012, Standard and Poor's Financial Services completed their annual review and made no changes to the existing ratings. All of the ratings have a stable outlook.

(b) Moody's Investor Service, Inc. updated their credit opinions on April 20, 2012 and made no changes to the credit ratings. All of the ratings have a stable outlook.

Covenants

Our debt instruments include senior notes, secured notes, first mortgage bonds, and revolving and term loan credit agreements containing numerous financial and operating covenants that place significant restrictions, which are described in Note 8 to the consolidated financial statements. We are currently in compliance with all debt covenants and in the event of a downgrade in our credit ratings, none of the covenants would be directly impacted, although the borrowing costs under our revolving and term loan credit agreements would increase.

Table of Contents

## Cash Flows

The following table summarizes cash flows for the periods indicated:

| (In thousands)  | Year Ended December 31, |                  |                 |
|---|-------------------------|------------------|-----------------|
|   | 2012                    | 2011             | 2010            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                         |                  |                 |
| Net income  | \$187,876               | \$171,685        | 145,678         |
| Adjustments to reconcile net income to net cash provided by operating activities:                       |                         |                  |                 |
| Depreciation and amortization expense   | 106,512                 | 94,981           | 86,976          |
| Recognition of and refund and collection of revenue accruals and deferrals — including accrued interest | (13,052                 | ) 56,944         | 121,315         |
| Deferred income tax expense   | 67,285                  | 30,797           | 76,746          |
| Tax benefit for excess tax deductions of share-based compensation                                       | (23,022                 | ) (28,114        | ) (320          |
| Other   | 1,924                   | 54,623           | (7,062          |
| Net cash provided by operating activities   | 327,523                 | 380,916          | 423,333         |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                         |                  |                 |
| Expenditures for property, plant and equipment  | (802,763                | ) (556,931       | ) (388,401      |
| Other   | (6,298                  | ) (3,264         | ) (460          |
| Net cash used in investing activities   | (809,061                | ) (560,195       | ) (388,861      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                         |                  |                 |
| Net issuance/repayment of long-term debt (including revolving and term loan credit agreements)          | 501,740                 | 147,660          | 62,034          |
| Issuance of common stock  | 14,189                  | 18,993           | 8,908           |
| Dividends on common stock   | (75,153                 | ) (70,363        | ) (66,041       |
| Refundable deposits from and repayments to generators for transmission network upgrades — net           | (4,943                  | ) 28,792         | (18,295         |
| Tax benefit for excess tax deductions of share-based compensation                                       | 23,022                  | 28,114           | 320             |
| Other   | (9,474                  | ) (10,682        | ) (1,142        |
| Net cash provided by (used in) financing activities   | 449,381                 | 142,514          | (14,216         |
| <b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>   | <b>(32,157</b>          | <b>) (36,765</b> | <b>) 20,256</b> |
| <b>CASH AND CASH EQUIVALENTS — Beginning of period</b>  | <b>58,344</b>           | <b>95,109</b>    | <b>74,853</b>   |
| <b>CASH AND CASH EQUIVALENTS — End of period</b>  | <b>\$26,187</b>         | <b>\$58,344</b>  | <b>95,109</b>   |

## Cash Flows From Operating Activities

Year ended December 31, 2012 compared to year ended December 31, 2011

Net cash provided by operating activities decreased \$53.4 million in 2012 compared to 2011. The decrease in cash provided by operating activities was due primarily to an increase in payments of operating expenses of \$46.2 million, including legal, advisory, consulting and financial services fees for the Entergy Transaction, higher income taxes paid of \$7.0 million and \$6.5 million of additional interest payments (net of interest capitalized) during 2012 compared to 2011. These decreases were partially offset by an increase in cash received from operating revenues of \$10.2 million.

Year ended December 31, 2011 compared to year ended December 31, 2010

Net cash provided by operating activities decreased \$42.4 million in 2011 compared to 2010. The decrease in cash provided by operating activities was due primarily to higher income taxes paid of \$25.3 million and \$6.3 million of additional interest payments (net of interest capitalized) during 2011 compared to 2010. Additionally, there was a decrease of \$27.8 million due to recognizing reductions of federal and state income tax liabilities related to tax benefits for excess tax deductions of share-based compensation recognized in 2011 that are reflected as financing cash inflows. These decreases were partially offset by an increase in cash received from operating revenues of \$9.3 million.





Table of Contents

Cash Flows From Investing Activities

Year ended December 31, 2012 compared to year ended December 31, 2011

Net cash used in investing activities increased \$248.9 million in 2012 compared to 2011. The increase in cash used in investing activities was due primarily to higher investments in property, plant and equipment during 2012 as we executed our capital investment plan described above under “— Overview — Capital Investment and Operating Results Trends.”

Year ended December 31, 2011 compared to year ended December 31, 2010

Net cash used in investing activities increased \$171.3 million in 2011 compared to 2010. The increase in cash used in investing activities was due primarily to higher investments in property, plant and equipment during 2011 as we executed our capital investment plan described above under “— Overview — Capital Investment and Operating Results Trends.”

Cash Flows From Financing Activities

Year ended December 31, 2012 compared to year ended December 31, 2011

Net cash provided by financing activities increased \$306.9 million in 2012 compared to 2011. The increase in cash provided by financing activities was due primarily to the proceeds of \$175.0 million received from the issuance of METC 3.98% Senior Secured Notes and ITC Midwest's 3.50% First Mortgage Bonds, Series E and the net increase of \$179.1 million in amounts outstanding under our revolving and term loan credit agreements. These increases were partially offset by higher net payments of \$33.7 million associated with refundable deposits for transmission network upgrades.

Year ended December 31, 2011 compared to year ended December 31, 2010

Net cash from financing activities increased \$156.7 million in 2011 compared to 2010. The increase in cash provided by financing activities was due primarily to the net increase of \$175.6 million in amounts outstanding under our revolving credit agreements, an increase of \$47.1 million in net proceeds associated with refundable deposits for transmission network upgrades as well as an increase of \$27.8 million due to the recognition of federal and state income tax liability reductions for the excess tax deduction of share-based compensation during 2011 compared to 2010. This increase was partially offset by no issuances of long-term debt in 2011 as compared to proceeds of \$40.0 million from the closing of ITC Midwest's 4.60% First Mortgage Bonds, Series D, and proceeds of \$50.0 million received from the issuance of METC's 5.64% Senior Secured Notes during 2010.

Table of Contents

## Contractual Obligations

The following table details our contractual obligations as of December 31, 2012:

| (In thousands)   | Total              | Less Than<br>1 Year | 1-3<br>Years       | 4-5<br>Years     | More Than<br>5 Years |
|--|--------------------|---------------------|--------------------|------------------|----------------------|
| <b>Debt:</b>   |                    |                     |                    |                  |                      |
| ITC Holdings Senior Notes  | 1,462,000          | 267,000             | 305,000            | 435,000          | 455,000              |
| ITC Holdings revolving credit agreement                                | 29,600             | —                   | 29,600             | —                | —                    |
| ITC Holdings term loan credit agreement                                | 200,000            | 200,000             | —                  | —                | —                    |
| ITCTransmission First Mortgage Bonds                                   | 385,000            | 185,000             | —                  | 100,000          | 100,000              |
| ITCTransmission revolving credit agreement                             | 78,700             | —                   | 78,700             | —                | —                    |
| METC Senior Secured Notes  | 350,000            | —                   | 225,000            | —                | 125,000              |
| METC revolving credit agreement  | 10,500             | —                   | 10,500             | —                | —                    |
| ITC Midwest First Mortgage Bonds                                       | 425,000            | —                   | —                  | 40,000           | 385,000              |
| ITC Midwest revolving credit agreement                                 | 115,300            | —                   | —                  | 115,300          | —                    |
| ITC Great Plains revolving credit agreement                            | 93,700             | —                   | 93,700             | —                | —                    |
| <b>Interest payments:</b>  |                    |                     |                    |                  |                      |
| ITC Holdings Senior Notes  | 665,460            | 79,219              | 204,322            | 81,988           | 299,931              |
| ITCTransmission First Mortgage Bonds                                   | 177,030            | 16,311              | 35,625             | 19,438           | 105,656              |
| METC Senior Secured Notes  | 202,241            | 19,183              | 40,148             | 11,610           | 131,300              |
| ITC Midwest First Mortgage Bonds                                       | 366,688            | 23,106              | 69,316             | 43,291           | 230,975              |
| Operating leases   | 1,390              | 862                 | 524                | 4                | —                    |
| Purchase obligations   | 94,274             | 93,547              | 727                | —                | —                    |
| Regulatory liabilities — revenue deferrals, including accrued interest | 82,376             | 53,763              | 28,613             | —                | —                    |
| Regulatory liabilities — FERC refund, including accrued interest       | 12,651             | —                   | 12,651             | —                | —                    |
| METC Easement Agreement  | 379,802            | 10,041              | 30,123             | 20,082           | 319,556              |
| <b>Total obligations</b>   | <b>\$5,131,712</b> | <b>\$948,032</b>    | <b>\$1,164,549</b> | <b>\$866,713</b> | <b>\$2,152,418</b>   |

Interest payments included above relate only to our fixed-rate long-term debt outstanding at December 31, 2012. We also expect to pay interest and commitment fees under our variable-rate revolving and term loan credit agreements that have not been included above due to varying amounts of borrowings and interest rates under the facilities. In 2012, we paid \$5.1 million of interest and commitment fees under our revolving and term loan credit agreements. Purchase obligations represent commitments for materials, services and equipment that had not been received as of December 31, 2012, primarily for construction and maintenance projects for which we have an executed contract. The majority of the items relate to materials and equipment that have long production lead times.

The regulatory liabilities — revenue deferrals, including accrued interest, included above represents the over-recovery of revenues resulting from differences between the amounts billed to customers and actual revenue requirement at each of our Regulated Operating Subsidiaries, as described in Note 4 to the consolidated financial statements. These amounts will offset future revenue requirement for purposes of calculating our formula rates as part of the true-up mechanism in our rate construct.

The regulatory liabilities — FERC refund, including accrued interest, represents the refund and related interest as a result of the FERC audit of ITC Midwest as discussed in Note 16 to the consolidated financial statements.

The Easement Agreement provides METC with an easement for transmission purposes and rights-of-way, leasehold interests, fee interests and licenses associated with the land over which the transmission lines cross. The cost for use of the rights-of-way is \$10.0 million per year. The term of the Easement Agreement runs through December 31, 2050 and is subject to 10 automatic 50-year renewals thereafter unless METC gives notice of nonrenewal of at least one year in advance. Payments to Consumers Energy under the Easement Agreement are charged to operation and

maintenance expense.

48

---

## Table of Contents

The contractual obligations table above excludes certain items, including certain long-term liabilities, due to uncertainty related to the timing and amount of future cash flows necessary to settle these obligations. The amount of cash flows to be paid for pension and other postretirement obligations, to settle regulatory liabilities related to asset removal costs, to refund deposits from generators for transmission network upgrades recorded in other long term liabilities and to settle interest rate swap derivative recorded in other current liabilities are not known with certainty. As a result, cash obligations for these items are excluded from the contractual obligations table above.

### Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of these consolidated financial statements requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. The application of these policies necessarily involves judgments regarding future events.

These estimates and judgments, in and of themselves, could materially impact the consolidated financial statements and disclosures based on varying assumptions, as future events rarely develop exactly as forecasted, and even the best estimates routinely require adjustment.

The following is a list of accounting policies that are most significant to the portrayal of our financial condition and results of operations and/or that require management’s most difficult, subjective or complex judgments.

### Regulation

Nearly all of our Regulated Operating Subsidiaries’ business is subject to regulation by the FERC. As a result, we apply accounting principles in accordance with the standards set forth by the Financial Accounting Standards Board (“FASB”) for accounting for the effects of certain types of regulation. Use of this accounting guidance results in differences in the application of GAAP between regulated and non-regulated businesses and requires the recording of regulatory assets and liabilities for certain transactions that would have been treated as expense or revenue in non-regulated businesses. Future regulatory changes or changes in the competitive environment could result in discontinuing the application of the guidance for accounting for the effects of certain types of regulations. If we were to discontinue the application of this guidance on our Regulated Operating Subsidiaries’ operations, we may be required to record losses of \$190.6 million relating to the regulatory assets at December 31, 2012 that are described in Note 5 to the consolidated financial statements. We also may be required to record losses of \$48.5 million relating to intangible assets at December 31, 2012 that are described in Note 6 to the consolidated financial statements.

Additionally, we may be required to record gains of \$170.5 million relating to regulatory liabilities at December 31, 2012, primarily for asset removal costs that have been accrued in advance of incurring these costs.

We believe that currently available facts support the continued applicability of the standards for accounting for the effects of certain types of regulation and that all regulatory assets and liabilities are recoverable or refundable under our current rate environment.

### Revenue Recognition under Cost-Based Formula Rates with True-Up Mechanism

Beginning January 1, 2007 for ITC Transmission and METC, January 1, 2008 for ITC Midwest and August 18, 2009 for ITC Great Plains, our Regulated Operating Subsidiaries recover expenses and earn a return on and recover investments in property, plant and equipment on a current rather than a lagging basis under their forward-looking cost-based formula rates with a true-up mechanism.

Under their formula rates, our Regulated Operating Subsidiaries use forecasted expenses, property, plant and equipment, point-to-point revenues and other items for the upcoming calendar year to establish their projected revenue requirement and their component of the billed network rates for service on their systems from January 1 to December 31 of that year. The 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 in order to subsequently collect or refund any under-recovery or over-recovery of revenues, as appropriate. The under- or over-collection typically results from differences between the projected revenue requirement used as the basis for billing and actual revenue requirement at each of our Regulated Operating Subsidiaries, and from differences between actual and projected monthly peak loads at our MISO Regulated Operating subsidiaries.

The true-up mechanism under our formula rates meet the requirements in the Accounting Standards Codification for accounting for rate-regulated utilities and the effects of certain alternative revenue programs. Accordingly,



Table of Contents

revenue is recognized during each reporting period based on actual revenue requirements calculated using the cost-based formula rate. Our Regulated Operating Subsidiaries accrue or defer revenues to the extent that their actual revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. The true-up amount is automatically reflected in customer bills within two years under the provisions of the formula rates.

Valuation of Goodwill

We have goodwill resulting from our acquisitions of ITCTransmission and METC and ITC Midwest's acquisition of the IP&L transmission assets. In accordance with the standards set forth by the FASB for goodwill, we are required to perform an impairment test annually or whenever events or circumstances indicate that the value of goodwill may be impaired. For goodwill impairment testing, we have the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test per the FASB guidance is unnecessary. The qualitative factors evaluated include macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, our historical share price as well as other industry specific considerations such as our regulatory environment and rate structure. However, if we conclude otherwise, then we are required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. To the extent estimated market-based valuation multiples and/or discounted cash flows are revised downward, we may be required to write down all or a portion of goodwill, which would adversely impact earnings.

As of December 31, 2012 and 2011, consolidated goodwill totaled \$950.2 million. We completed our annual goodwill impairment test by performing a qualitative analysis for each of our MISO Regulated Operating Subsidiaries as of October 1, 2012 and determined that no impairment exists. There were no events subsequent to October 1, 2012 that indicated impairment of our goodwill. We do not believe there is a material risk of our goodwill being impaired in the near term at ITCTransmission, METC or ITC Midwest.

Contingent Obligations

We are subject to a number of federal and state laws and regulations, as well as other factors and conditions that potentially subject us to environmental, litigation, income tax and other risks. We periodically evaluate our exposure to such risks and record reserves for those matters where a loss is considered probable and reasonably estimable in accordance with GAAP. The adequacy of reserves can be significantly affected by external events or conditions that can be unpredictable; thus, the ultimate outcome of such matters could materially affect our consolidated financial statements. These events or conditions include, without limitation, the following:

- Changes in existing state or federal regulation by governmental authorities having jurisdiction over air quality, water quality, control of toxic substances, hazardous and solid wastes, and other environmental matters.
- Changes in existing federal income tax laws or Internal Revenue Service regulations.
- Identification and evaluation of potential lawsuits or complaints in which we may be or have been named as a defendant.
- Resolution or progression of existing matters through the legislative process, the courts, the Internal Revenue Service, or the Environmental Protection Agency.

Share-Based Awards

Our accounting for share-based payments requires us to determine the fair value of awards of ITC Holdings' common stock issued in the form of restricted stock and stock option awards. We use the value of ITC Holdings' common stock at the date of the grant in the calculation of the fair value of our share-based awards. The restricted stock awards are recorded at fair value at the date of the grant. The fair value of stock options held by our employees is determined using a Black-Scholes option valuation method, which is a valuation technique that is acceptable for share-based payment accounting. Key assumptions in determining fair value include volatility, risk-free interest rate, dividend yield and expected term. In the event different assumptions were used, a different fair value would be derived that could cause the related expense to be materially higher or lower. We amortize the fair value of the awards on a

straight-line basis (net of any estimated forfeitures) over the vesting period of the awards.



## Table of Contents

### Pension and Postretirement Costs

We sponsor certain post-employment benefits for our employees, which include retirement plans and certain postretirement health care, dental and life insurance benefits. Our periodic costs and obligations associated with these post-employment plans are developed from actuarial valuations derived from a number of assumptions including rates of return on plan assets, the discount rate, the rate of increase in health care costs, the amount and timing of plan sponsor contributions and demographic factors such as retirements, mortality and turnover, among others. We evaluate these assumptions annually and update them periodically to reflect our actual experience. Three critical assumptions in determining our periodic costs and obligations are discount rate, expected long-term return on plan assets and the rate of increases in health care costs. The discount rate represents the market rate for synthesized AA rated zero coupon bonds with durations corresponding to the expected durations of the benefit obligations and is used to calculate the present value of the expected future cash flows for benefit obligations under our post-employment plans. For our rate of return on plan assets, we consider the current and expected asset allocations, as well as historical and expected long-term rates of return on those types of plan assets, in determining the expected long-term return on plan assets. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans as described in Note 11 to the consolidated financial statements.

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a material effect on our financial condition.

### Recent Accounting Pronouncements

See Note 3 to the consolidated financial statements.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

### Commodity Price Risk

We have commodity price risk at our Regulated Operating Subsidiaries arising from market price fluctuations for materials such as copper, aluminum, steel, oil and gas and other goods used in construction and maintenance activities. Higher costs of these materials are passed on to us by the contractors for these activities. These items affect only cash flows, as the amounts are included as components of net revenue requirement and any higher costs are included in rates under their cost-based formula rates.

### Interest Rate Risk

#### Fixed Rate Long-Term Debt

Based on the borrowing rates currently available for bank loans with similar terms and average maturities, the fair value of our consolidated long-term debt and debt maturing within one year, excluding our revolving and term loan credit agreements, was \$3,072.9 million at December 31, 2012. The total book value of our consolidated long-term debt and debt maturing within one year, excluding our revolving and term loan credit agreements, was \$2,619.4 million at December 31, 2012. We performed an analysis calculating the impact of changes in interest rates on the fair value of long-term debt and debt maturing within one year, excluding our revolving and term loan credit agreements, at December 31, 2012. An increase in interest rates of 10% (from 7.0% to 7.7%, for example) at December 31, 2012 would decrease the fair value of debt by \$68.8 million, and a decrease in interest rates of 10% at December 31, 2012 would increase the fair value of debt by \$73.5 million at that date.

#### Revolving and Term Loan Credit Agreements

At December 31, 2012, we had a consolidated total of \$527.8 million outstanding under our revolving and term loan credit agreements, which are variable rate loans and fair value approximates book value. A 10% increase or decrease in borrowing rates under the revolving and term loan credit agreements compared to the weighted average rates in effect at December 31, 2012 would increase or decrease the total interest expense by \$0.8 million, respectively, for an annual period on a constant borrowing level of \$527.8 million.

#### 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



Table of Contents

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 manage interest rate risk associated with the forecasted future issuance 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 borrowed under the existing ITC Holdings Corp. unsecured, unguaranteed term loan credit agreement, due August 23, 2013, prior to its maturity.

**Credit Risk**

Our credit risk is primarily with Detroit Edison, Consumers Energy and IP&L, which were responsible for 26.7%, 25.6% and 27.0%, respectively, or \$221.8 million, \$212.3 million and \$223.9 million, respectively, of our consolidated operating revenues for 2012. These percentages assume a portion of the 2012 revenue accruals and deferrals included in our 2012 operating revenues, which will be billed or refunded to our customers in 2013, would be paid by Detroit Edison, Consumers Energy and IP&L in the future based on the respective percentage of network and regional cost sharing revenues billed to them in 2012. Under Detroit Edison's and Consumers Energy's current rate structure, Detroit Edison and Consumers Energy include in their retail rates the actual cost of transmission services provided by ITCTransmission and METC, respectively, in their billings to their customers, effectively passing through to end-use consumers the total cost of transmission service. IP&L currently includes in their retail rates an allowance for transmission services provided by ITC Midwest in their billings to their customers. However, any financial difficulties experienced by Detroit Edison, Consumers Energy or IP&L may affect their ability to make payments for transmission service to ITCTransmission, METC and ITC Midwest, which could negatively impact our business. MISO, as our MISO Regulated Operating Subsidiaries' billing agent, bills Detroit Edison, Consumers Energy, IP&L and other customers on a monthly basis and collects fees for the use of our transmission systems. SPP, the billing agent for ITC Great Plains, began to bill ITC Great Plains' 2009 network revenues in January 2010, retroactive to August 18, 2009. MISO and SPP have implemented strict credit policies for its members' customers, which include customers using our transmission systems. In general, if these customers do not maintain their investment grade credit rating or have a history of late payments, MISO and SPP may require them to provide MISO and the SPP with a letter of credit or cash deposit equal to the highest monthly invoiced amount over the previous twelve months.

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The following financial statements and schedules are included herein:

|  | Page       |
|--|------------|
| <u>Management's Report on Internal Control over Financial Reporting</u>  | <u>54</u>  |
| <u>Report of Independent Registered Public Accounting Firm</u>   | <u>55</u>  |
| <u>Report of Independent Registered Public Accounting Firm</u>   | <u>56</u>  |
| <u>Consolidated Statements of Financial Position as of December 31, 2012 and 2011</u>                                  | <u>57</u>  |
| <u>Consolidated Statements of Operations for the Years Ended December 31, 2012, 2011 and 2010</u>                      | <u>58</u>  |
| <u>Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2012, 2011 and 2010</u>            | <u>59</u>  |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2012, 2011 and 2010</u> | <u>60</u>  |
| <u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2012, 2011 and 2010</u>                      | <u>61</u>  |
| <u>Notes to Consolidated Financial Statements</u>  | <u>62</u>  |
| <u>Schedule I — Condensed Financial Information of Registrant</u>  | <u>102</u> |

Table of Contents

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is designed to provide reasonable, not absolute, assurance as to the reliability of our financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. Internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, internal control over financial reporting determined to be effective can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements.

Under management's supervision, an evaluation of the design and effectiveness of our internal control over financial reporting was conducted based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our assessment included extensive documenting, evaluating and testing of the design and operating effectiveness of our internal control over financial reporting. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2012.

Deloitte & Touche LLP, an independent registered public accounting firm, as auditors of our consolidated financial statements, has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2012. Deloitte & Touche LLP's report, which expresses an unqualified opinion on the effectiveness of our internal control over financial reporting, is included herein.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
ITC Holdings Corp.:

We have audited the accompanying consolidated statements of financial position of ITC Holdings Corp. and subsidiaries (the “Company”) as of December 31, 2012 and 2011 and the related consolidated statements of operations, comprehensive income, changes in stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of ITC Holdings Corp. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2012, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 1, 2013 expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Detroit, Michigan  
March 1, 2013

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
ITC Holdings Corp.:

We have audited the internal control over financial reporting of ITC Holdings Corp. and subsidiaries (the “Company”) as of December 31, 2012, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2012 of the Company and our report dated March 1, 2013 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

Detroit, Michigan  
March 1, 2013

Table of ContentsITC HOLDINGS CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| (In thousands, except share data)   | December 31,       |                    |
|---|--------------------|--------------------|
|   | 2012               | 2011               |
| <b>ASSETS</b>   |                    |                    |
| Current assets  |                    |                    |
| Cash and cash equivalents   | \$26,187           | \$58,344           |
| Accounts receivable   | 72,192             | 76,895             |
| Inventory   | 37,357             | 34,855             |
| Deferred income taxes   | 23,014             | 20,636             |
| Regulatory assets — revenue accruals, including accrued interest  | 7,489              | 6,639              |
| Prepaid assets  | 29,235             | 4,129              |
| Other   | 2,752              | 30                 |
| Total current assets  | 198,226            | 201,528            |
| Property, plant and equipment (net of accumulated depreciation and amortization of \$1,269,810 and \$1,193,164, respectively)                                       | 4,134,579          | 3,415,823          |
| Other assets  |                    |                    |
| Goodwill  | 950,163            | 950,163            |
| Intangible assets (net of accumulated amortization of \$18,397 and \$15,276, respectively)  | 48,492             | 46,885             |
| Other regulatory assets   | 180,378            | 161,987            |
| Deferred financing fees (net of accumulated amortization of \$17,838 and \$14,594, respectively)  | 19,293             | 20,989             |
| Other   | 33,678             | 25,991             |
| Total other assets  | 1,232,004          | 1,206,015          |
| <b>TOTAL ASSETS</b>   | <b>\$5,564,809</b> | <b>\$4,823,366</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                    |                    |
| Current liabilities   |                    |                    |
| Accounts payable  | \$123,022          | \$136,934          |
| Accrued payroll   | 20,740             | 18,013             |
| Accrued interest  | 44,708             | 43,642             |
| Accrued taxes   | 28,117             | 25,627             |
| Regulatory liabilities — revenue deferrals, including accrued interest  | 53,763             | 46,579             |
| Refundable deposits from generators for transmission network upgrades   | 40,745             | 38,805             |
| Debt maturing within one year   | 651,929            | —                  |
| Other   | 40,287             | 5,867              |
| Total current liabilities   | 1,003,311          | 315,467            |
| Accrued pension and postretirement liabilities  | 53,243             | 44,923             |
| Deferred income taxes   | 460,072            | 373,268            |
| Regulatory liabilities — revenue deferrals, including accrued interest  | 28,613             | 50,917             |
| Regulatory liabilities — accrued asset removal costs  | 75,477             | 83,934             |
| Refundable deposits from generators for transmission network upgrades   | 7,623              | 14,570             |
| Other   | 26,317             | 36,373             |
| Long-term debt  | 2,495,298          | 2,645,022          |
| Commitments and contingent liabilities (Notes 4 and 16)   |                    |                    |
| <b>STOCKHOLDERS' EQUITY</b>   |                    |                    |
| Common stock, without par value, 100,000,000 shares authorized, 52,248,514 and 51,323,368 shares issued and outstanding at December 31, 2012 and 2011, respectively | 989,334            | 943,444            |



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

|   |                    |                    |   |
|---|--------------------|--------------------|---|
| Retained earnings                                 | 443,569            | 330,816            |   |
| Accumulated other comprehensive loss              | (18,048            | ) (15,368          | ) |
| Total stockholders' equity                        | 1,414,855          | 1,258,892          |   |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$5,564,809</b> | <b>\$4,823,366</b> |   |

See notes to consolidated financial statements.

Table of ContentsITC HOLDINGS CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

| (In thousands, except per share data)               | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2012                    | 2011      | 2010      |
| OPERATING REVENUES                                  | \$830,535               | \$757,397 | \$696,843 |
| OPERATING EXPENSES                                  |                         |           |           |
| Operation and maintenance                           | 121,941                 | 129,288   | 126,528   |
| General and administrative                          | 112,091                 | 82,790    | 78,120    |
| Depreciation and amortization                       | 106,512                 | 94,981    | 86,976    |
| Taxes other than income taxes                       | 59,701                  | 53,430    | 48,195    |
| Other operating (income) and expense — net          | (769)                   | (844)     | (297)     |
| Total operating expenses                            | 399,476                 | 359,645   | 339,522   |
| OPERATING INCOME                                    | 431,059                 | 397,752   | 357,321   |
| OTHER EXPENSES (INCOME)                             |                         |           |           |
| Interest expense                                    | 155,734                 | 146,936   | 142,553   |
| Allowance for equity funds used during construction | (23,000)                | (16,699)  | (13,412)  |
| Other income  | (2,401)                 | (2,881)   | (2,340)   |
| Other expense                                       | 4,218                   | 3,962     | 2,588     |
| Total other expenses (income)                       | 134,551                 | 131,318   | 129,389   |
| INCOME BEFORE INCOME TAXES                          | 296,508                 | 266,434   | 227,932   |
| INCOME TAX PROVISION                                | 108,632                 | 94,749    | 82,254    |
| NET INCOME  | \$187,876               | \$171,685 | \$145,678 |
| Basic earnings per common share                     | \$3.65                  | \$3.36    | \$2.89    |
| Diluted earnings per common share                   | \$3.60                  | \$3.31    | \$2.84    |
| Dividends declared per common share                 | \$1.460                 | \$1.375   | \$1.310   |
| See notes to consolidated financial statements.     |                         |           |           |

Table of Contents

## ITC HOLDINGS CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (In thousands)  | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2012                    | 2011      | 2010      |
| NET INCOME  | \$187,876               | \$171,685 | \$145,678 |
| OTHER COMPREHENSIVE (LOSS) INCOME   |                         |           |           |
| Amortization of interest rate lock cash flow hedges (net of tax of \$31, \$1 and \$34 for the years ended December 31, 2012, 2011 and 2010, respectively)   | 67                      | 97        | 64        |
| Unrealized (loss) gain on interest rate swaps relating to interest rate cash flow hedges (net of tax of \$1,777, \$10,705 and \$1,211 for the years ended December 31, 2012, 2011 and 2010, respectively) | (2,747                  | ) (16,653 | ) 1,889   |
| TOTAL OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX   | (2,680                  | ) (16,556 | ) 1,953   |
| TOTAL COMPREHENSIVE INCOME  | \$185,196               | \$155,129 | \$147,631 |

See notes to consolidated financial statements.

Table of Contents

ITC HOLDINGS CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN  
STOCKHOLDERS' EQUITY

|   | Common Stock |           | Retained  | Accumulated                             | Total                   |
|---|--------------|-----------|-----------|---|-------------------------|
|   | Shares       | Amount    | Earnings  | Other<br>Comprehensive<br>Income (Loss) | Stockholders'<br>Equity |
| (In thousands, except share and per share data)   |              |           |           |   |                         |
| BALANCE, DECEMBER 31, 2009  | 50,084,061   | \$862,512 | \$149,776 | \$ (765 )                               | \$1,011,523             |
| Net income  | —            | —         | 145,678   | —                                       | 145,678                 |
| Repurchase and retirement of common stock   | (1,057 )     | (61 )     | —         | —                                       | (61 )                   |
| Dividends declared on common stock (\$1.310 per share)  | —            | —         | (66,048 ) | —                                       | (66,048 )               |
| Stock option exercises  | 464,264      | 7,786     | —         | —                                       | 7,786                   |
| Shares issued under the Employee Stock Purchase Plan  | 24,840       | 1,122     | —         | —                                       | 1,122                   |
| Issuance of restricted stock  | 152,737      | —         | —         | —                                       | —                       |
| Forfeiture of restricted stock  | (14,404 )    | —         | 31        | —                                       | 31                      |
| Vesting of deferred stock units   | 5,364        | —         | —         | —                                       | —                       |
| Share-based compensation, net of forfeitures  | —            | 14,843    | —         | —                                       | 14,843                  |
| Amortization of interest rate lock cash flow hedges, net of tax of \$34                                   | —            | —         | —         | 64                                      | 64                      |
| Unrealized gain on interest rate swaps relating to interest rate cash flow hedges, net of tax of \$1,211  | —            | —         | —         | 1,889                                   | 1,889                   |
| Tax benefit for excess tax deductions of share-based compensation   | —            | 320       | —         | —                                       | 320                     |
| Other   | —            | 286       | —         | —                                       | 286                     |
| BALANCE, DECEMBER 31, 2010  | 50,715,805   | \$886,808 | \$229,437 | \$ 1,188                                | \$1,117,433             |
| Net income  | —            | —         | 171,685   | —                                       | 171,685                 |
| Repurchase and retirement of common stock   | (89,715 )    | (6,401 )  | —         | —                                       | (6,401 )                |
| Dividends declared on common stock (\$1.375 per share)  | —            | —         | (70,363 ) | —                                       | (70,363 )               |
| Stock option exercises  | 543,775      | 17,666    | —         | —                                       | 17,666                  |
| Shares issued under the Employee Stock Purchase Plan  | 23,027       | 1,327     | —         | —                                       | 1,327                   |
| Issuance of restricted stock  | 142,999      | —         | —         | —                                       | —                       |
| Forfeiture of restricted stock  | (18,012 )    | —         | 57        | —                                       | 57                      |
| Vesting of deferred stock units   | 5,489        | —         | —         | —                                       | —                       |
| Share-based compensation, net of forfeitures  | —            | 15,334    | —         | —                                       | 15,334                  |
| Amortization of interest rate lock cash flow hedges, net of tax of \$1                                    | —            | —         | —         | 97                                      | 97                      |
| Unrealized loss on interest rate swaps relating to interest rate cash flow hedges, net of tax of \$10,705 | —            | —         | —         | (16,653 )                               | (16,653 )               |
| Tax benefit for excess tax deductions of share-based compensation   | —            | 28,114    | —         | —                                       | 28,114                  |
| Other   | —            | 596       | —         | —                                       | 596                     |
| BALANCE, DECEMBER 31, 2011  | 51,323,368   | \$943,444 | \$330,816 | \$ (15,368 )                            | \$1,258,892             |
| Net income  | —            | —         | 187,876   | —                                       | 187,876                 |

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

|  |            |           |           |              |              |
|--|------------|-----------|-----------|--------------|--------------|
| Repurchase and retirement of common stock  | (99,533 )  | (7,266 )  | —         | —            | (7,266 )     |
| Dividends declared on common stock (\$1.460 per share)   | —          | —         | (75,153 ) | —            | (75,153 )    |
| Stock option exercises   | 851,720    | 12,593    | —         | —            | 12,593       |
| Shares issued under the Employee Stock Purchase Plan   | 25,521     | 1,596     | —         | —            | 1,596        |
| Issuance of restricted stock   | 158,599    | —         | —         | —            | —            |
| Forfeiture of restricted stock   | (11,161 )  | —         | 30        | —            | 30           |
| Share-based compensation, net of forfeitures   | —          | 15,592    | —         | —            | 15,592       |
| Amortization of interest rate lock cash flow hedges, net of tax of \$31                                  | —          | —         | —         | 67           | 67           |
| Unrealized loss on interest rate swaps relating to interest rate cash flow hedges, net of tax of \$1,777 | —          | —         | —         | (2,747 )     | (2,747 )     |
| Tax benefit for excess tax deductions of share-based compensation  | —          | 23,022    | —         | —            | 23,022       |
| Other  | —          | 353       | —         | —            | 353          |
| BALANCE, DECEMBER 31, 2012   | 52,248,514 | \$989,334 | \$443,569 | \$ (18,048 ) | \$ 1,414,855 |

See notes to consolidated financial statements.

Table of ContentsITC HOLDINGS CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands)  | Year Ended December 31, |             |             |
|---|-------------------------|-------------|-------------|
|   | 2012                    | 2011        | 2010        |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                         |             |             |
| Net income  | \$187,876               | \$171,685   | \$145,678   |
| Adjustments to reconcile net income to net cash provided by operating activities:                 |                         |             |             |
| Depreciation and amortization expense   | 106,512                 | 94,981      | 86,976      |
| Recognition, refund and collection of revenue accruals and deferrals — including accrued interest | (13,052)                | ) 56,944    | 121,315     |
| Deferred income tax expense   | 67,285                  | 30,797      | 76,746      |
| Allowance for equity funds used during construction   | (23,000)                | ) (16,699)  | ) (13,412)  |
| Other — net   | 13,772                  | 13,361      | 14,311      |
| Changes in assets and liabilities, exclusive of changes shown separately:                         |                         |             |             |
| Accounts receivable   | 1,721                   | 2,434       | (9,479)     |
| Inventory   | (2,502)                 | ) 7,431     | (5,452)     |
| Prepaid and other current assets  | (25,102)                | ) 1,134     | (2,049)     |
| Accounts payable  | (5,400)                 | ) 12,573    | 2,210       |
| Accrued payroll   | 1,583                   | (1,096)     | ) 4,893     |
| Accrued interest  | 1,066                   | 917         | 3,626       |
| Accrued taxes   | 24,247                  | 34,279      | (2,071)     |
| Tax benefit for excess tax deductions of share-based compensation                                 | (23,022)                | ) (28,114)  | ) (320)     |
| Other current liabilities   | 2,912                   | (246)       | ) 2,770     |
| Other non-current assets and liabilities, net   | 12,627                  | 535         | (2,409)     |
| Net cash provided by operating activities   | 327,523                 | 380,916     | 423,333     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                         |             |             |
| Expenditures for property, plant and equipment  | (802,763)               | ) (556,931) | ) (388,401) |
| Proceeds from sale of securities  | 5,935                   | 3,839       | 14,576      |
| Purchases of securities   | (11,779)                | ) (8,136)   | ) (14,587)  |
| Other   | (454)                   | ) 1,033     | (449)       |
| Net cash used in investing activities   | (809,061)               | ) (560,195) | ) (388,861) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                         |             |             |
| Issuance of long-term debt  | 175,000                 | —           | 90,000      |
| Borrowings under revolving credit agreements  | 1,355,150               | 1,065,215   | 475,627     |
| Borrowings under term loan credit agreement   | 200,000                 | —           | —           |
| Repayments of revolving credit agreements   | (1,228,410)             | ) (917,555) | ) (503,593) |
| Issuance of common stock  | 14,189                  | 18,993      | 8,908       |
| Dividends on common stock   | (75,153)                | ) (70,363)  | ) (66,041)  |
| Refundable deposits from generators for transmission network upgrades                             | 33,310                  | 35,768      | 21,618      |
| Repayment of refundable deposits from generators for transmission network upgrades                | (38,253)                | ) (6,976)   | ) (39,913)  |
| Tax benefit for excess tax deductions of share-based compensation                                 | 23,022                  | 28,114      | 320         |
| Other   | (9,474)                 | ) (10,682)  | ) (1,142)   |
| Net cash provided by (used in) financing activities   | 449,381                 | 142,514     | (14,216)    |
| <b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>                                       | (32,157)                | ) (36,765)  | ) 20,256    |
| CASH AND CASH EQUIVALENTS — Beginning of period   | 58,344                  | 95,109      | 74,853      |
| CASH AND CASH EQUIVALENTS — End of period   | \$26,187                | \$58,344    | \$95,109    |

See notes to consolidated financial statements.

61

---

Table of Contents

ITC HOLDINGS CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

ITC Holdings Corp. (“ITC Holdings,” and together with its subsidiaries, “we,” “our” or “us”) and its subsidiaries are engaged in the transmission of electricity in the United States. Through our operating subsidiaries, ITCTransmission, METC, ITC Midwest and ITC Great Plains (together, our “Regulated Operating Subsidiaries”), we operate high-voltage systems in Michigan’s Lower Peninsula and portions of Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma that transmit electricity from generating stations to local distribution facilities connected to our systems. Our business strategy is to operate, maintain and invest in transmission infrastructure in order to enhance system integrity and reliability, to reduce transmission constraints and to allow new generating resources to interconnect to our transmission systems. We also are pursuing development projects not within our existing systems, which are intended to improve overall grid reliability, lower electricity congestion and facilitate interconnections of new generating resources, as well as to enhance competitive wholesale electricity markets.

Our Regulated Operating Subsidiaries are independent electric transmission utilities, with rates regulated by the FERC and established on a cost-of-service model. ITCTransmission’s service area is located in southeastern Michigan and METC’s service area covers approximately two-thirds of Michigan’s Lower Peninsula and is contiguous with ITCTransmission’s service area. ITC Midwest’s service area is located in portions of Iowa, Minnesota, Illinois and Missouri and ITC Great Plains currently owns assets located in Kansas and Oklahoma. The Midwest Independent Transmission System Operator, Inc. (“MISO”) bills and collects revenues from ITCTransmission, METC, and ITC Midwest (“MISO Regulated Operating Subsidiaries”) customers. The Southwest Power Pool, Inc. (“SPP”) bills and collects revenue from ITC Great Plains customers.

2. SIGNIFICANT ACCOUNTING POLICIES

A summary of the major accounting policies followed in the preparation of the accompanying consolidated financial statements, which conform to accounting principles generally accepted in the United States of America (“GAAP”), is presented below:

**Principles of Consolidation** — ITC Holdings consolidates its majority owned subsidiaries. We eliminate all intercompany balances and transactions.

**Use of Estimates** — The preparation of the consolidated financial statements in accordance with GAAP requires 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.

**Regulation** — Our Regulated Operating Subsidiaries are subject to the regulatory jurisdiction of the FERC, which issues orders pertaining to rates, recovery of certain costs, including the costs of transmission assets and regulatory assets, conditions of service, accounting, financing authorization and operating-related matters. The utility operations of our Regulated Operating Subsidiaries meet the accounting standards set forth by the Financial Accounting Standards Board (“FASB”) for the accounting effects of certain types of regulation. These accounting standards recognize the cost based rate setting process, which results in differences in the application of GAAP between regulated and non-regulated businesses. These standards require the recording of regulatory assets and liabilities for transactions that would have been recorded as revenue and expense in non-regulated businesses. Regulatory assets represent costs that will be included as a component of future tariff rates and regulatory liabilities represent amounts provided in the current tariff rates that are intended to recover costs expected to be incurred in the future or amounts to be refunded to customers.

**Cash and Cash Equivalents** — We consider all unrestricted highly-liquid temporary investments with an original maturity of three months or less at the date of purchase to be cash equivalents.



Table of Contents

Consolidated Statements of Cash Flows — The following table presents certain supplementary cash flows information for the years ended December 31, 2012, 2011 and 2010:

| (In thousands)   | Year Ended December 31, |            |            |
|--|-------------------------|------------|------------|
|  | 2012                    | 2011       | 2010       |
| Supplementary cash flows information:                                      |                         |            |            |
| Interest paid (net of interest capitalized)                                | \$ 148,598              | \$ 142,101 | \$ 135,771 |
| Income taxes paid  | 41,174                  | 34,127     | 8,844      |
| Supplementary non-cash investing and financing activities:                 |                         |            |            |
| Additions to property, plant and equipment and other long-lived assets (a) | \$ 94,218               | \$ 102,091 | \$ 44,496  |
| Allowance for equity funds used during construction                        | 23,000                  | 16,699     | 13,412     |

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 December 31, 2012, 2011 or 2010, respectively, but have (a) been or will be included as a cash outflow from investing activities for expenditures for property, plant and equipment when paid.

Excess tax benefits are recognized as an addition to common stock per the share-based compensation accounting standards. Cash retained as a result of those excess tax benefits are presented in the statement of cash flows as cash inflows from financing activities and cash outflows from operating activities.

Accounts Receivable — We recognize losses for uncollectible accounts based on specific identification of any such items. As of December 31, 2012 and 2011, we did not have an accounts receivable reserve.

Inventories — Materials and supplies inventories are valued at average cost. Additionally, the costs of warehousing activities are recorded here and included in the cost of materials when requisitioned.

Property, Plant and Equipment — Depreciation and amortization expense on property, plant and equipment was \$97.3 million, \$85.8 million and \$77.8 million for 2012, 2011 and 2010, respectively.

Property, plant and equipment in service at our Regulated Operating Subsidiaries is stated at its original cost when first devoted to utility service. The gross book value of assets retired less salvage proceeds is charged to accumulated depreciation. The provision for depreciation of transmission assets is a significant component of our Regulated Operating Subsidiaries' cost of service under FERC-approved rates. Depreciation is computed over the estimated useful lives of the assets using the straight-line method for financial reporting purposes and accelerated methods for income tax reporting purposes. The composite depreciation rate for our Regulated Operating Subsidiaries included in our consolidated statements of operations was 2.4% for 2012, 2011 and 2010. The composite depreciation rates include depreciation primarily on transmission station equipment, towers, poles and overhead and underground lines that have a useful life ranging from 48 to 60 years. The portion of depreciation expense related to asset removal costs is added to regulatory liabilities and removal costs incurred are deducted from regulatory liabilities. Our Regulated Operating Subsidiaries capitalize to property, plant and equipment an allowance for the cost of equity and borrowings used during construction ("AFUDC") in accordance with FERC regulations. AFUDC represents the composite cost incurred to fund the construction of assets, including interest expense and a return on equity capital devoted to construction of assets. The AFUDC debt of \$7.0 million, \$4.7 million and \$3.9 million for 2012, 2011 and 2010, respectively, was a reduction to interest expense. Certain projects at ITC Great Plains have been granted an incentive to include construction work in progress balances in rate base, and we do not record AFUDC on those projects. For acquisitions of property, plant and equipment greater than the net book value (other than asset acquisitions accounted for under the purchase method of accounting that result in goodwill), the acquisition premium is recorded to property, plant and equipment and amortized over the estimated remaining useful lives of the assets using the straight-line method for financial reporting purposes and accelerated methods for income tax reporting purposes. Property, plant and equipment includes capital equipment inventory stated at original cost consisting of items that are expected to be used exclusively for capital projects.



Table of Contents

We capitalize the costs associated with computer software we develop or obtain for use in our business, which is included in property, plant and equipment. We amortize computer software costs on a straight-line basis over the expected period of benefit once the installed software is ready for its intended use.

Property, plant and equipment at ITC Holdings and non-regulated subsidiaries is stated at its acquired cost. Proceeds from salvage less the net book value of assets disposed of is recognized as a gain or loss on disposal. Depreciation is computed based on the acquired cost less expected residual value and is recognized over the estimated useful lives of the assets on a straight-line method for financial reporting purposes and accelerated methods for income tax reporting purposes.

**Impairment of Long-Lived Assets** — Other than goodwill, our long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. If the carrying amount of the asset exceeds the expected undiscounted future cash flows generated by the asset, an impairment loss is recognized resulting in the asset being written down to its estimated fair value.

**Goodwill and Intangible Assets** — We comply with the standards set forth by the FASB for goodwill and other intangible assets. Under these standards, goodwill and other intangibles with indefinite lives are not subject to amortization. However, goodwill and other intangibles with indefinite lives are subject to fair value-based rules for measuring impairment, and resulting write-downs, if any, are to be reflected in operating expense. These accounting standards require that goodwill be reviewed at least annually for impairment and whenever facts or circumstances indicate that the carrying amounts may not be recoverable. We have goodwill recorded relating to the acquisitions of each our MISO Regulated Operating Subsidiaries. We completed our annual goodwill impairment test by performing a qualitative analysis for each of our MISO Regulated Operating Subsidiaries as of October 1, 2012 and determined that no impairment exists. There were no events subsequent to October 1, 2012 that indicated impairment of our goodwill. Our intangible assets have finite lives and are amortized over their useful lives, refer to Note 6.

**Deferred Financing Fees and Discount or Premium on Debt** — The costs related to the issuance of long-term debt are recorded to deferred financing fees and are amortized over the life of the debt issue. The debt discount or premium related to the issuance of long-term debt is recorded to long-term debt and amortized over the life of the debt issue. We recorded to interest expense the amortization of deferred financing fees and the amortization of our debt discounts for 2012, 2011 and 2010 of \$4.0 million, \$3.8 million and \$3.1 million, respectively.

**Asset Retirement Obligations** — We comply with the standards set forth by the FASB for asset retirement obligations. As defined in the standards, a conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within our control. We have identified conditional asset retirement obligations primarily associated with the removal of equipment containing polychlorinated biphenyls (“PCBs”) and asbestos. We record a liability at fair value for a legal asset retirement obligation in the period in which it is incurred. When a new legal obligation is recorded, we capitalize the costs of the liability by increasing the carrying amount of the related long-lived asset. We accrete the liability to its present value each period and depreciate the capitalized cost over the useful life of the related asset. At the end of the asset’s useful life, we settle the obligation for its recorded amount or incur a gain or loss. The standards for asset retirement obligation applied to our Regulated Operating Subsidiaries require us to recognize regulatory assets or liabilities for the timing differences between when we recover legal asset retirement obligations in rates and when we would recognize these costs under the standards. There have not been any significant changes to our asset retirement obligations in 2012. Our asset retirement obligations as of December 31, 2012 and 2011 of \$5.1 million and \$3.6 million, respectively, are included in other liabilities.

**Financial Instruments** — We comply with the standards set forth by the FASB for derivatives and hedging in accounting for financial instruments. For derivative instruments that have been designated and qualify as hedges of the exposure to variability in expected future cash flows, the gain or loss on the derivative is initially reported as a component of other comprehensive income (loss) and reclassified to the consolidated statement of operations when the underlying hedged transaction affects net income. Any hedge ineffectiveness is recognized in net income immediately at the time the gain or loss on the derivative instruments is calculated. Refer to Note 8 for additional discussion regarding derivative instruments.



Table of Contents

**Contingent Obligations** — We are subject to a number of federal and state laws and regulations, as well as other factors and conditions that potentially subject us to environmental, litigation and other risks. We periodically evaluate our exposure to such risks and record reserves for those matters where a loss is considered probable and reasonably estimable in accordance with GAAP. The adequacy of reserves can be significantly affected by external events or conditions that can be unpredictable; thus, the ultimate outcome of such matters could materially affect our consolidated financial statements.

**Generator Interconnection Projects** — Certain capital investment at our Regulated Operating Subsidiaries relates to investments we make under generator interconnection agreements. The generator interconnection agreements typically consist of both transmission network upgrades, which have been deemed by FERC to benefit the transmission system as a whole, as well as direct connection facilities, which are needed to interconnect the generating facility to the transmission system and primarily benefit the generating facility. Our investment in transmission network upgrade facilities are recorded to property, plant and equipment. For direct connection facilities, we collect a contribution in aid of construction from the generator for the cost of the facilities and offset the contribution against the plant investment recorded to property, plant and equipment.

We receive deposits or letters of credit from the generator for the network upgrade facilities in advance of construction. When the generator meets certain criteria of Attachment FF of the MISO tariff, such as having a long-term sales agreement at the commercial operation date for the generating capacity of the facility, we refund the cash deposits or release the letter of credit that was provided. If the generator does not meet these criteria, the deposit is retained or other security drawn upon, and is recorded as an offset against the plant investment recorded to property, plant and equipment. When the cash or other security received is not refunded under the criteria of Attachment FF, the receipt of cash becomes taxable income for us for which we bill the generator a tax gross-up. The tax gross-up represents the difference between the tax effects of the taxable income associated with the contribution compared to the present value of the tax depreciation deduction of the property constructed using the taxable contribution in aid of construction. The deferred revenues associated with the tax gross-up are recorded to other long-term liabilities when collected, and amortized over the tax depreciation life of the asset to other operating income and expense-net.

**Revenues** — Revenues from the transmission of electricity are recognized as services are provided based on FERC-approved cost-based formula rate templates. We record a reserve for revenue subject to refund when such refund is probable and can be reasonably estimated. The reserve is recorded as a reduction to operating revenues. The cost-based formula rate templates at our Regulated Operating Subsidiaries include a true-up mechanism, whereby they compare their actual revenue requirements to their billed revenues for each year to determine any over- or under-collection of revenue requirements and record a revenue accrual or deferral for the difference. Refer to Note 4 under “Cost-Based Formula Rates with True-Up Mechanism” for a discussion of our revenue accounting under our cost-based formula rate templates.

**Share-Based Payment** — We have an Amended and Restated 2003 Stock Purchase and Option Plan for Key Employees of ITC Holdings Corp. and its subsidiaries (“2003 Plan”) and a Second Amended and Restated 2006 Long-Term Incentive Plan (“LTIP”) pursuant to which we grant various share-based awards, including options and restricted stock. Compensation expense is recorded for stock options and restricted stock awards that are expected to vest based on their fair value at grant date, and is amortized over the expected vesting period. We recognize expense for our stock options, which have graded vesting schedules, on a straight-line basis over the entire vesting period and not for each separately vesting portion of the award. The grant date is the date at which our commitment to issue share based awards to the employee or a director arises, which is generally the later of the board approval date, the date of hire of the employee or the date of the employee’s compensation agreement which contains the commitment to issue the award.

We also have an Employee Stock Purchase Plan (“ESPP”) which is a compensatory plan. Compensation expense is recorded based on the fair value of the purchase options at the grant date, which corresponds to the first day of each purchase period, and is amortized over the purchase period.

**Comprehensive Income (Loss)** — Comprehensive income (loss) is the change in common stockholders’ equity during a period arising from transactions and events from non-owner sources, including net income and any gain or loss recognized for the effective portion of our interest rate swaps.



Table of Contents

Income Taxes — Deferred income taxes are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. Deferred tax assets and liabilities are determined based on the differences between the financial statements and tax bases of various assets and liabilities using the tax rates expected to be in effect for the year in which the differences are expected to reverse.

The accounting standards for uncertainty in income taxes prescribe a recognition threshold and a measurement attribute for tax positions taken, or expected to be taken, in a tax return that may not be sustainable.

We file income tax returns with the Internal Revenue Service and with various state and city jurisdictions. We are no longer subject to U.S. federal tax examinations for tax years 2008 and earlier. State and city jurisdictions that remain subject to examination range from tax years 2008 to 2011. In the event we are assessed interest or penalties by any income tax jurisdictions, interest would be recorded as interest expense and penalties would be recorded as other expense.

### 3. RECENT ACCOUNTING PRONOUNCEMENTS

#### Presentation of Comprehensive Income

The guidance set forth by the Financial Accounting Standards Board (“FASB”) for the presentation of comprehensive income in financial statements was revised to require entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. This revision became effective for our annual consolidated financial statements for the year ended December 31, 2012 and we have included a separate statement of comprehensive income for all periods presented.

In 2013, the FASB issued updated guidance to accumulated other comprehensive income reporting. Under this guidance, we will be required to present the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income. The revision will be effective for our annual and interim consolidated financial statements for the fiscal year beginning after December 31, 2012 and is not expected to have a material impact on our disclosures.

#### 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). The disclosure requirements are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods therein, with retrospective application required. The new disclosure requirements are not expected to have a material effect on our consolidated financial statements.

#### Fair Value Disclosures

The FASB amended guidance for fair value measurements and disclosures. The guidance requires additional disclosures relating to fair value measurements categorized within Level 3 of the fair value hierarchy, including quantitative information about unobservable inputs, the valuation process used by the entity and the sensitivity of unobservable input measurements. Additionally, entities are required to disclose the level of the fair value hierarchy for assets and liabilities that are not measured at fair value in the balance sheet, but for which disclosure of the fair value is required. We adopted this guidance as of January 1, 2012, which did not have a material impact on our disclosures. See Note 12 for additional information.

Table of Contents

4. REGULATORY MATTERS

ITC Great Plains

In 2009, ITC Great Plains acquired two electric transmission substations and became an independent transmission company in SPP. The FERC approved certain transmission investment incentives, including the establishment of regulatory assets for start-up and development costs of ITC Great Plains and certain pre-construction costs specific to the KETA Project and the Kansas V-Plan to be recovered pursuant to future FERC filings. In 2010, the FERC accepted ITC Great Plains' cost-based formula rate tariff sheets, which include an annual true-up mechanism, and their corresponding implementation protocols.

As of December 31, 2012, 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 KETA Project and the Kansas V-Plan Project prior to construction. During the first quarter of 2011, we received certain regulatory approvals relating to the Kansas V-Plan Project which resulted in the recognition of a regulatory asset for the Kansas V-Plan Project of \$2.0 million and a corresponding reduction to operating expenses, which increased net income by \$1.3 million. Subsequent to the initial recognition of the Kansas V-Plan Project regulatory asset in March 2011, we recorded costs for the Kansas V-Plan Project directly to this regulatory asset. 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 Federal Power Act ("FPA") in order to recover these start-up, development and pre-construction expenses in future rates. If FERC authorization is received, ITC Great Plains will include the regulatory assets in its rate base and begin amortizing them over a 10-year period. The amortization expense will be included in ITC Great Plains' revenue requirement derived from its cost-based formula rate template.

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 FPA. 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 that such rate formula is unjust and unreasonable or that 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





Table of Contents

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. The regulatory assets are recorded on the balance sheet in regulatory assets — revenue accruals, including accrued interest and other non-current assets. 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 year ended December 31, 2012:

| (In thousands)  | Total       |
|---|-------------|
| Balance as of December 31, 2011                                       | \$(85,220 ) |
| Net refund of 2010 revenue deferrals and accruals, including interest | 40,633      |
| Net revenue deferrals for the year ended December 31, 2012            | (24,866 )   |
| Net accrued interest payable for the year ended December 31, 2012     | (2,715 )    |
| Balance as of December 31, 2012                                       | \$(72,168 ) |

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

| (In thousands)                  | Total       |
|---------------------------------|-------------|
| Current assets                  | \$7,489     |
| Non-current assets — other      | 2,719       |
| Current liabilities             | (53,763 )   |
| Non-current liabilities         | (28,613 )   |
| Balance as of December 31, 2012 | \$(72,168 ) |

**ITC Midwest's Rate Discount**

As part of the orders by the Iowa Utility Board ("IUB") and the Minnesota Public Service Commission approving ITC Midwest's asset acquisition, ITC Midwest agreed to provide a rate discount of \$4.1 million per year to its customers for eight years, beginning in the first year customers experience an increase in transmission charges following the consummation of the ITC Midwest asset acquisition. Beginning in 2009 and extending through 2016, ITC Midwest's net revenue requirement was or will be reduced by \$4.1 million for each year. The rate discount is recognized as a reduction in revenues when we provide the service and charge the reduced rate that includes the rate discount.

**ITCTransmission Rate Freeze Revenue Deferral**

ITCTransmission's rate freeze revenue deferral resulted from the difference between the revenue ITCTransmission would have collected under its cost based formula rate and the actual revenue ITCTransmission received for the period from February 28, 2003 through December 31, 2004. The rate freeze revenue deferral was amortized for ratemaking on a straight-line basis for five years from June 2006 through May 2011 and was included in ITCTransmission's revenue requirement for those periods. Revenues of \$5.0 million relating to the rate freeze revenue deferral were recognized in January through May 2011.

Table of Contents

## 5. REGULATORY ASSETS AND LIABILITIES

## Regulatory Assets

The following table summarizes the regulatory asset balances at December 31, 2012 and 2011:

| (In thousands)  | 2012      | 2011      |
|---|-----------|-----------|
| Regulatory Assets:  |           |           |
| Revenue accruals:   |           |           |
| Current (including accrued interest of \$131 and \$79 as of December 31, 2012 and 2011, respectively)                                   | \$7,489   | \$6,639   |
| Non-current (including accrued interest of \$17 and \$34 as of December 31, 2012 and 2011, respectively)                                | 2,719     | 5,637     |
| Other:  |           |           |
| ITCTransmission ADIT Deferral (net of accumulated amortization of \$29,796 and \$26,766 as of December 31, 2012 and 2011, respectively) | 30,806    | 33,836    |
| METC ADIT Deferral (net of accumulated amortization of \$14,152 and \$11,793 as of December 31, 2012 and 2011, respectively)            | 28,304    | 30,663    |
| METC Regulatory Deferrals (net of accumulated amortization of \$4,628 and \$3,857 as of December 31, 2012 and 2011, respectively)       | 10,800    | 11,571    |
| Income taxes recoverable related to AFUDC equity  | 57,135    | 38,222    |
| ITC Great Plains Start-up and Development   | 9,126     | 8,946     |
| KETA and Kansas V-Plan Projects   | 4,991     | 4,900     |
| Pensions and postretirement   | 28,847    | 24,711    |
| Income taxes recoverable related to implementation of the Michigan Corporate Income Tax   | 8,869     | 7,630     |
| Other   | 1,500     | 1,508     |
| Total   | \$190,586 | \$174,263 |

## Revenue Accruals

Refer to discussion of revenue accruals in Note 4 under “Cost-Based Formula Rates with True-Up Mechanism.” Our Regulated Operating Subsidiaries do not earn a return on the balance of the revenue accruals, but do accrue interest carrying costs which are subject to rate recovery along with the principal amount of the revenue accrual.

## ITCTransmission ADIT Deferral

The carrying amount of the ITCTransmission Accumulated Deferred Income Tax (“ADIT”) Deferral is the remaining unamortized balance of the portion of ITCTransmission’s purchase price in excess of the fair value of net assets acquired approved for inclusion in future rates by the FERC. ITCTransmission earns a return on the remaining unamortized balance of the ITCTransmission ADIT Deferral that is included in rate base. The original amount recorded for this regulatory asset of \$60.6 million is recognized in rates and amortized on a straight-line basis over 20 years. ITCTransmission recorded amortization expense of \$3.0 million annually during 2012, 2011 and 2010, which is included in depreciation and amortization and recovered through ITCTransmission’s cost-based formula rate template.

## METC ADIT Deferral

The carrying amount of the METC ADIT Deferral is the remaining unamortized balance of the portion of METC’s purchase price in excess of the fair value of net assets acquired from Consumers Energy approved for inclusion in future rates by the FERC. The original amount recorded for the regulatory asset for METC ADIT Deferral of \$42.5 million is recognized in rates and amortized on a straight-line basis over 18 years beginning January 1, 2007. METC earns a return on the remaining unamortized balance of the regulatory asset for METC ADIT Deferral that is included in rate base. METC recorded amortization expense of \$2.4 million annually during 2012, 2011 and 2010, respectively, which is included in depreciation and amortization and recovered through METC’s cost-based formula rate template.

Table of Contents

## METC Regulatory Deferrals

METC has deferred, as a regulatory asset, depreciation and related interest expense associated with new transmission assets placed in service from January 1, 2001 through December 31, 2005 that were included on METC's balance sheet at the time MTH acquired METC from Consumers Energy (the "METC Regulatory Deferrals"). The original amount recorded for the regulatory asset for METC Regulatory Deferrals of \$15.4 million is recognized in rates and amortized over 20 years beginning January 1, 2007. METC earns a return on the remaining unamortized balance of the METC Regulatory Deferrals that is included in rate base. METC recorded amortization expense of \$0.8 million during 2012, 2011 and 2010, respectively, which is included in depreciation and amortization and recovered through METC's cost-based formula rate template.

## Income Taxes Recoverable Related to AFUDC Equity

Accounting standards for income taxes provide that a regulatory asset be recorded if it is probable that a future increase in taxes payable relating to the book depreciation of AFUDC equity that has been capitalized to property, plant and equipment will be recovered from customers through future rates. Because AFUDC equity is a component of property, plant and equipment that is included in rate base when the plant is placed in service, and the related deferred tax liabilities are not a reduction to rate base, we effectively earn a return on this regulatory asset.

## ITC Great Plains Start-up and Development

The start-up and development regulatory asset consists of certain costs incurred by ITC Great Plains from inception through the effective date of the ITC Great Plains' cost-based formula rate, including costs which had been incurred to develop and acquire transmission assets in the SPP region. These costs relate primarily to obtaining various state, SPP and FERC approvals necessary for ITC Great Plains to own transmission assets and build new facilities in the SPP region, efforts to establish the ITC Great Plains' cost-based formula rate, the establishment of ITC Great Plains as a public utility in Kansas and Oklahoma, as well as obtaining the necessary approvals and authorizations for the state regulators in Kansas and Oklahoma.

The startup and development regulatory asset accrues carrying charges at a rate equivalent to ITC Great Plains' weighted average cost of capital, adjusted annually based on ITC Great Plains' actual weighted average cost of capital calculated in ITC Great Plains' formula rate template for that year. The carrying charges began to accrue in March 2009 and will continue until such time that the regulatory asset is included in rate base. The equity component of these carrying charges including applicable taxes, totaling \$4.4 million as of December 31, 2012, is not recorded for GAAP accounting and reporting as the equity return does not meet the recognition criteria of incurred costs eligible for deferral under GAAP. Recovery of the start-up and development regulatory asset requires FERC authorization upon ITC Great Plains making an additional filing under Section 205 of the FPA to demonstrate that the costs to be recovered are just and reasonable. If FERC authorization is received, ITC Great Plains will include the unamortized balance of the start-up and development regulatory assets in its rate base and will begin amortizing it over a 10-year period upon the in-service date of the KETA Project, the Kansas V-Plan or when the total in-service gross property, plant and equipment at ITC Great Plains exceeds \$100 million, whichever occurs first. The amortization expense will be recovered through ITC Great Plains' cost-based formula rate template beginning in the period in which amortization begins.

## KETA and Kansas V-Plan Projects

The KETA and Kansas V-Plan Project regulatory assets includes certain costs incurred associated with regulatory activities in Kansas and Oklahoma and with participants in SPP to obtain the necessary approvals and authorization before proceeding further with plans, as well as engineering studies, routing studies and education and outreach to stakeholders on ITC Great Plains' efforts to bring these projects to the SPP region, and other costs incurred specific to the KETA and V-Plan Projects prior to construction. The KETA and Kansas V-Plan Projects regulatory assets accrue carrying charges at a rate equivalent to ITC Great Plains' weighted average cost of capital, adjusted annually based on ITC Great Plains' actual weighted average cost of capital calculated in its formula rate template for that year. The carrying charges began to accrue in March 2009 as authorized by the FERC Order and will continue until such time that the regulatory assets are included in rate base. The equity component of these carrying charges including applicable taxes, totaling \$1.7 million as of December 31, 2012, is not recorded for GAAP accounting and reporting as the equity return does not meet the recognition criteria of incurred costs eligible for deferral under GAAP.

Recovery of the KETA and Kansas V-Plan Project regulatory assets require FERC authorization upon ITC Great Plains making an additional filing under Section 205 of the FPA to demonstrate that the costs to be recovered are just and reasonable. If FERC authorization is received, ITC Great Plains will include

70

---

Table of Contents

the unamortized balance of the KETA and Kansas V-Plan Project regulatory assets in its rate base and begin amortizing them over a 10-year period upon the in-service date of each of the projects. The amortization expense will be recovered through ITC Great Plains' cost-based formula rate template beginning in the period in which amortization begins.

**Pensions and Postretirement**

Accounting standards for defined benefit pension and other postretirement plans for rate-regulated entities require that amounts that otherwise would have been charged and or credited to accumulated other comprehensive income are recorded as a regulatory asset or liability. As the unrecognized amounts recorded to this regulatory asset are recognized, expenses will be recovered from customers in future rates under our cost based formula rates. Our Regulated Operating Subsidiaries do not earn a return on the balance of the Pension and Postretirement regulatory asset.

**Income Taxes Recoverable Related to Implementation of the Michigan Corporate Income Tax**

On May 25, 2011, the Michigan Business Tax ("MBT") was repealed and replaced with the Michigan Corporate Income Tax ("CIT"), effective January 1, 2012. Under the CIT, we were taxed at a rate of 6.0% on federal taxable income that is attributed to our operations in the state of Michigan, subject to certain adjustments. In addition to the traditional income tax, the MBT had also included a modified gross receipts tax which allowed for deductions and credits for certain activities, none of which are part of the CIT. The change in Michigan tax law required us to remove deferred income tax balances recognized under the MBT and establish new deferred income tax balances under the CIT in 2011, and the net result was incremental deferred state income tax liabilities at both ITCTransmission and METC. Under our cost-based formula rates with true-up mechanism, the future taxes receivable as a result of the tax law change is expected to be collected from customers through future rates and has resulted in the recognition of a regulatory asset. Recovery of the Michigan CIT regulatory asset requires FERC authorization upon ITC Holdings making an additional filing under Section 205 of the FPA to demonstrate that the costs to be recovered are just and reasonable. ITCTransmission and METC do not earn a return on the balance of the CIT regulatory asset.

**Regulatory Liabilities**

The following table summarizes the regulatory liability balances at December 31, 2012 and 2011:

| (In thousands)   | 2012      | 2011      |
|--|-----------|-----------|
| Regulatory Liabilities:  |           |           |
| Revenue deferrals (a):   |           |           |
| Current (including accrued interest of \$2,492 and \$2,159 as of December 31, 2012 and 2011, respectively) | \$53,763  | \$46,579  |
| Non-current (including accrued interest of \$473 and \$828 as of December 31, 2012 and 2011, respectively) | 28,613    | 50,917    |
| Accrued asset removal costs  | 75,477    | 83,934    |
| FERC refund (including accrued interest of \$1,679 as of December 31, 2012) (b)                            | 12,651    | —         |
| Total  | \$170,504 | \$181,430 |

Refer to discussion of revenue deferrals in Note 4 under "Cost-Based Formula Rates with True-Up Mechanism." Our (a) Regulated Operating Subsidiaries accrue interest on the true-up amounts which will be refunded through rates along with the principal amount of revenue deferrals in future periods.

(b) Refer to discussion of FERC refund in Note 16 under "FERC Audit of ITC Midwest."

**Accrued Asset Removal Costs**

The carrying amount of the accrued asset removal costs represents the cumulative amount collected from customers to cover the estimated future costs to remove property, plant and equipment at retirement. The portion of depreciation expense included in our depreciation rates related to asset removal costs is added to this regulatory liability and removal expenditures incurred are charged to this regulatory liability. In addition, the regulatory liability is also adjusted for timing differences between when we recover legal asset retirement obligations in our rates and when we would recognize these costs under the standards set forth by the FASB. Our Regulated Operating



Table of Contents

Subsidiaries include this item, excluding the cost component related to the recognition of our asset retirement obligations under the standards set forth by the FASB, within accumulated depreciation for rate-making purposes, which is a reduction to rate base.

**6. GOODWILL AND INTANGIBLE ASSETS**

At December 31, 2012 and 2011, we had goodwill balances recorded at ITCTransmission, METC and ITC Midwest of \$173.4 million, \$453.8 million and \$323.0 million, respectively, which resulted from the ITCTransmission acquisition, the METC acquisition and ITC Midwest's asset acquisition, respectively.

**Intangible Assets**

Pursuant to the METC acquisition in October 2006, we have identified intangible assets with finite lives derived from the portion of regulatory assets recorded on METC's historical FERC financial statements that were not recorded on METC's historical GAAP financial statements associated with the METC Regulatory Deferrals and the METC ADIT Deferral. The carrying amount of the intangible asset for METC Regulatory Deferrals at December 31, 2012 and 2011 is \$27.7 million and \$29.7 million, respectively, and is amortized over 20 years beginning January 1, 2007. The carrying amount of the intangible asset for METC ADIT Deferral at December 31, 2012 and 2011 is \$12.6 million and \$13.6 million, respectively, and is amortized over 18 years beginning January 1, 2007, which also corresponds to the amortization period established in the METC rate case settlement. METC earns an equity return on the remaining unamortized balance of both the intangible asset for METC Regulatory Deferrals and the intangible asset for METC ADIT Deferral and recovers the amortization expense through METC's cost-based formula rate template.

ITC Great Plains has recorded intangible assets for payments made 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 is \$8.2 million and \$3.6 million (net of accumulated amortization of \$0.3 million and \$0.2 million, respectively) as of December 31, 2012 and 2011, respectively.

During each of the years ended December 31, 2012, 2011 and 2010, we recognized \$3.1 million of amortization expense of our intangible assets. We expect the annual amortization of our intangible assets that have been recorded as of December 31, 2012 to be as follows:

(In thousands)

|                     |          |
|---------------------|----------|
| 2013                | \$3,196  |
| 2014                | 3,196    |
| 2015                | 3,196    |
| 2016                | 3,196    |
| 2017                | 3,196    |
| 2018 and thereafter | 32,512   |
| Total               | \$48,492 |



Table of Contents

## 7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment — net consisted of the following at December 31, 2012 and 2011:

| (In thousands)                                  | 2012         | 2011         |
|---|--------------|--------------|
| Property, plant and equipment                   |              |              |
| Regulated Operating Subsidiaries:               |              |              |
| Property, plant and equipment in service        | \$4,779,833  | \$4,096,211  |
| Construction work in progress                   | 501,847      | 418,056      |
| Capital equipment inventory                     | 86,882       | 68,881       |
| Other   | 22,481       | 12,490       |
| ITC Holdings and other                          | 13,346       | 13,349       |
| Total   | 5,404,389    | 4,608,987    |
| Less: Accumulated depreciation and amortization | (1,269,810 ) | (1,193,164 ) |
| Property, plant and equipment — net             | \$4,134,579  | \$3,415,823  |

Additions to property, plant and equipment in service and construction work in progress during 2012 and 2011 were due primarily for projects to upgrade or replace existing transmission plant to improve the reliability of our transmission systems in addition to generator interconnections and our ongoing development projects.

Table of Contents

## 8. DEBT

The following amounts were outstanding at December 31, 2012 and 2011:

| (Amounts in thousands)   | 2012        | 2011        |
|--|-------------|-------------|
| ITC Holdings 5.25% Senior Notes due July 15, 2013 (net of discount of \$65 and \$183, respectively) (a)                      | \$266,935   | \$266,817   |
| ITC Holdings 6.04% Senior Notes, Series A, due September 20, 2014  | 50,000      | 50,000      |
| ITC Holdings 5.875% Senior Notes due September 30, 2016 (net of discount of \$12 and \$16, respectively)                     | 254,988     | 254,984     |
| ITC Holdings 6.23% Senior Notes, Series B, due September 20, 2017  | 50,000      | 50,000      |
| ITC Holdings 6.375% Senior Notes due September 30, 2036 (net of discount of \$182 and \$189, respectively)                   | 254,818     | 254,811     |
| ITC Holdings 6.05% Senior Notes due January 31, 2018 (net of discount of \$802 and \$960, respectively)                      | 384,198     | 384,040     |
| ITC Holdings 5.50% Senior Notes due January 15, 2020 (net of discount of \$920 and \$1,053, respectively)                    | 199,080     | 198,947     |
| ITC Holdings Term Loan Credit Agreement due August 23, 2013 (a)  | 200,000     | —           |
| ITC Holdings Revolving Credit Agreement due May 17, 2016   | 29,600      | —           |
| ITC Transmission 4.45% First Mortgage Bonds, Series A, due July 15, 2013 (net of discount of \$6 and \$18, respectively) (a) | 184,994     | 184,982     |
| ITC Transmission 6.125% First Mortgage Bonds, Series C, due March 31, 2036 (net of discount of \$85 and \$89, respectively)  | 99,915      | 99,911      |
| ITC Transmission 5.75% First Mortgage Bonds, Series D, due April 1, 2018 (net of discount of \$60 and \$72, respectively)    | 99,940      | 99,928      |
| ITC Transmission Revolving Credit Agreement due May 17, 2016   | 78,700      | 18,000      |
| METC 5.75% Senior Secured Notes due December 10, 2015  | 175,000     | 175,000     |
| METC 6.63% Senior Secured Notes due December 18, 2014  | 50,000      | 50,000      |
| METC 5.64% Senior Secured Notes due May 6, 2040  | 50,000      | 50,000      |
| METC 3.98% Senior Secured Notes due October 26, 2042   | 75,000      | —           |
| METC Revolving Credit Agreement due May 17, 2016   | 10,500      | 37,600      |
| ITC Midwest 6.15% First Mortgage Bonds, Series A, due January 31, 2038 (net of discount of \$441 and \$458, respectively)    | 174,559     | 174,542     |
| ITC Midwest 7.12% First Mortgage Bonds, Series B, due December 22, 2017  | 40,000      | 40,000      |
| ITC Midwest 7.27% First Mortgage Bonds, Series C, due December 22, 2020  | 35,000      | 35,000      |
| ITC Midwest 4.60% First Mortgage Bonds, Series D, due December 17, 2024  | 75,000      | 75,000      |
| ITC Midwest 3.50% First Mortgage Bonds, Series E, due January 19, 2027   | 100,000     | —           |
| ITC Midwest 2008 Revolving Credit Agreement due January 29, 2013 (b)   | —           | 40,000      |
| ITC Midwest 2011 Revolving Credit Agreement due February 11, 2013 (b)  | —           | 52,200      |
| ITC Midwest Revolving Credit Agreement due May 31, 2017  | 115,300     | —           |
| ITC Great Plains Revolving Credit Agreement due February 16, 2015  | 93,700      | 53,260      |
| Total debt   | \$3,147,227 | \$2,645,022 |

(a) As of December 31, 2012, there was \$651.9 million of debt included within debt maturing within one year, that is classified as a current liability in the consolidated statements of financial position.

(b) The debt arrangements were retired prior to the maturity date.

Table of Contents

The annual maturities of debt as of December 31, 2012 are as follows:

(In thousands)

|                     |             |
|---------------------|-------------|
| 2013                | \$652,000   |
| 2014                | 100,000     |
| 2015                | 268,700     |
| 2016                | 373,800     |
| 2017                | 205,300     |
| 2018 and thereafter | 1,550,000   |
| Total               | \$3,149,800 |

#### ITC Holdings

The ITC Holdings Senior Notes are issued under ITC Holdings' indenture. All issuances of ITC Holdings Senior Notes are unsecured.

On August 23, 2012, ITC Holdings entered into a new unsecured, unguaranteed term loan credit agreement, under which ITC Holdings borrowed \$200.0 million. The proceeds were used for general corporate purposes, including the repayment of borrowings under the ITC Holdings' revolving credit agreement. The term loan is scheduled to mature on August 23, 2013. The weighted-average interest rate on the borrowing outstanding under the agreement was 1.2% at 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, under which ITC Holdings borrowed \$100.0 million. The proceeds were used for general corporate purposes, including the repayment of borrowings under the ITC Holdings' revolving credit agreement. The term loan is scheduled to mature on December 31, 2013.

#### ITCTransmission

The ITCTransmission First Mortgage Bonds are issued under ITCTransmission's First Mortgage and Deed of Trust, and therefore have the benefit of a first mortgage lien on substantially all of ITCTransmission's property.

#### METC

On October 26, 2012, METC issued \$75.0 million aggregate principal amount of its 3.98% Senior Secured Notes, due October 26, 2042 (the "METC Senior Secured Notes"). The METC Senior Secured Notes are secured by a first mortgage lien on substantially all of METC's real property and tangible personal property. The proceeds were used primarily to refinance existing indebtedness, partially fund capital expenditures and for general corporate purposes.

#### ITC Midwest

ITC Midwest closed on the \$100.0 million of 3.50% First Mortgage Bonds, Series E, due January 2027 on January 19, 2012. 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.

#### 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 issuance 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 borrowed under the existing ITC Holdings Corp. unsecured, unguaranteed term loan credit agreement, due August 23, 2013, prior to its maturity:

Table of Contents

| 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      |
| Total                 | \$225.0         |            |               |                |

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 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. As of December 31, 2012, there has been no material ineffectiveness recorded in the 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 December 31, 2012, the fair value of the derivative instruments was an asset of \$2.7 million recorded to other current assets and a liability of \$31.5 million recorded to other current liabilities. None of the interest rate swaps contain credit-risk-related contingent features. Refer to Note 12 for additional fair value information.

Revolving Credit Agreements

On May 31, 2012, ITC Midwest entered into a new unsecured, unguaranteed revolving credit agreement, under which ITC Midwest may borrow up to \$175.0 million. The new revolving credit agreement replaced ITC Midwest's two existing revolving credit agreements which were scheduled to mature in early 2013. At December 31, 2012, 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 |
|-------------------------------------|--------------------------|-------------------------|-----------------|---|-------------------------|---------------|------------------|
| <u>Revolving Credit Agreements:</u> |                          |                         |                 |   |                         |               |                  |
| ITC Holdings                        | \$200.0                  | \$29.6                  | \$170.4         | 2.0%  | 0.25                    | % 5 years     | May 2016         |
| ITCTransmission                     | 100.0                    | 78.7                    | 21.3            | 1.4%  | 0.125                   | % 5 years     | May 2016         |
| METC                                | 100.0                    | 10.5                    | 89.5            | 1.4%  | 0.125                   | % 5 years     | May 2016         |
| ITC Midwest                         | 175.0                    | 115.3                   | 59.7            | 1.2%  | 0.10                    | % 5 years     | May 2017         |
| ITC Great Plains                    | 150.0                    | 93.7                    | 56.3            | 2.0%  | 0.30                    | % 4 years     | February 2015    |
| Total                               | \$725.0                  | \$327.8                 | \$397.2         |   |                         |               |                  |

(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.

Table of Contents

## 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 funds from operations ratios, debt to capitalization ratios and maintaining certain interest coverage ratios in addition to non-GAAP covenants. We are currently in compliance with all debt covenants.

## 9. 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 years ended December 31, 2012, 2011 and 2010 is presented in the following table:

| (Amounts in thousands)  | Year Ended December 31, |            |            |
|---|-------------------------|------------|------------|
|   | 2012                    | 2011       | 2010       |
| Numerator:  |                         |            |            |
| Net income  | \$187,876               | \$171,685  | \$145,678  |
| Less: dividends declared — common shares, restricted shares and deferred stock units (a)                    | (75,124 )               | (70,305 )  | (66,017 )  |
| Undistributed earnings  | 112,752                 | 101,380    | 79,661     |
| Percentage allocated to common shares (b)   | 98.7                    | % 98.3     | % 98.3     |
| Undistributed earnings — common shares  | 111,286                 | 99,657     | 78,307     |
| Add: dividends declared — common shares   | 74,202                  | 69,200     | 64,926     |
| Numerator for basic and diluted earnings per common share   | \$185,488               | \$168,857  | \$143,233  |
| Denominator:  |                         |            |            |
| Denominator for basic earnings per common share — weighted-average common shares                            | 50,820,838              | 50,289,905 | 49,526,580 |
| Incremental shares for stock options and employee stock purchase plan                                       | 742,557                 | 788,918    | 871,459    |
| Denominator for diluted earnings per common share — adjusted weighted-average shares and assumed conversion | 51,563,395              | 51,078,823 | 50,398,039 |
| Per common share net income:  |                         |            |            |
| Basic   | \$3.65                  | \$3.36     | \$2.89     |
| Diluted   | \$3.60                  | \$3.31     | \$2.84     |

(a) Includes dividends paid in the form of shares for deferred stock units.

|  |            |            |            |
|--|------------|------------|------------|
| (b) Weighted-average common shares outstanding   | 50,820,838 | 50,289,905 | 49,526,580 |
| Weighted-average restricted shares and deferred stock units (participating securities) | 658,835    | 854,717    | 842,108    |
| Total  | 51,479,673 | 51,144,622 | 50,368,688 |
| Percentage allocated to common shares  | 98.7       | % 98.3     | % 98.3     |

Table of Contents

Stock options are included in the diluted earnings per share calculation using the treasury stock method, unless the effect of including the stock options would be anti-dilutive. The outstanding stock options at December 31, 2012, 2011 and 2010 and the anti-dilutive stock options excluded from the diluted earnings per share calculations for the years ended December 31, 2012, 2011 and 2010 were as follows:

|                             | 2012      | 2011      | 2010      |
|-----------------------------|-----------|-----------|-----------|
| Outstanding stock options   | 1,603,429 | 2,100,056 | 2,436,742 |
| Anti-dilutive stock options | 565,945   | 213,917   | 225,740   |

**10. INCOME TAXES**

Our effective tax rate varied from the statutory federal income tax rate due to differences between the book and tax treatment of various transactions as follows:

| (In thousands)                              | 2012      | 2011     | 2010     |
|---|-----------|----------|----------|
| Income tax expense at 35% statutory rate    | \$103,778 | \$93,252 | \$79,776 |
| State income taxes (net of federal benefit) | 6,247     | 4,766    | 4,208    |
| AFUDC equity                                | (7,207)   | (5,292)  | (3,998)  |
| Other — net                                 | 5,814     | 2,023    | 2,268    |
| Income tax provision                        | \$108,632 | \$94,749 | \$82,254 |

Components of the income tax provision were as follows:

| (In thousands)                          | 2012      | 2011     | 2010     |
|---|-----------|----------|----------|
| Current income tax expense              | \$41,347  | \$63,952 | \$5,508  |
| Deferred income tax expense             | 66,710    | 33,266   | 6,989    |
| Benefits of operating loss carryforward | 575       | 2,169    | 69,757   |
| Change in Michigan tax law              | —         | (4,638)  | —        |
| Total income tax provision              | \$108,632 | \$94,749 | \$82,254 |

Deferred tax assets and liabilities are recognized for the estimated future tax effect of temporary differences between the tax basis of assets or liabilities and the reported amounts in the financial statements. Deferred tax assets and liabilities are classified as current or non-current according to the classification of the related assets or liabilities.

Deferred tax assets and liabilities not related to assets or liabilities are classified according to the expected reversal date of the temporary differences.

Deferred income tax assets (liabilities) consisted of the following at December 31:

| (In thousands)  | 2012        | 2011        |
|---|-------------|-------------|
| Property, plant and equipment                                     | \$(378,196) | \$(303,647) |
| METC regulatory deferral (a)                                      | (14,884)    | (15,907)    |
| Acquisition adjustments — ADIT deferrals (a)                      | (14,852)    | (14,635)    |
| Goodwill  | (102,994)   | (87,331)    |
| Revenue accruals/deferrals — net (including accrued interest) (a) | 28,121      | 33,424      |
| Pension and postretirement liabilities                            | 9,706       | 16,971      |
| State income tax NOLs (net of federal benefit)                    | 11,759      | 10,582      |
| Share-based compensation  | 10,281      | 11,546      |
| Other — net   | 14,001      | (3,635)     |
| Net deferred tax liabilities                                      | \$(437,058) | \$(352,632) |
| Gross deferred income tax liabilities                             | \$(572,088) | \$(435,940) |
| Gross deferred income tax assets                                  | 135,030     | 83,308      |
| Net deferred tax liabilities                                      | \$(437,058) | \$(352,632) |

Table of Contents

(a)Described in Note 5.

We have estimated state income tax net operating losses (“NOLs”) as of December 31, 2012, all of which we expect to use prior to their expiration. Our state income tax NOLs would expire beginning in 2027. We have recorded estimated state income tax NOL deferred tax assets of \$11.8 million as of December 31, 2012. We have additional state income tax NOLs of \$5.6 million tax effected, net of federal benefit, that have not been recognized in the consolidated statements of financial position relating to tax deductions for share-based payment. The accounting standards for share-based payment require that the tax deductions that exceed book value be recognized only if that deduction reduces taxes payable as a result of a realized cash benefit from the deduction.

#### Michigan Corporate Income Tax

On May 25, 2011, the Michigan Business Tax was repealed and replaced with the Michigan Corporate Income Tax, effective January 1, 2012. Under the CIT, we are taxed at a rate of 6.0% on federal taxable income apportioned to Michigan, subject to certain adjustments. In addition to the traditional income tax, the MBT had also included a modified gross receipts tax which allowed for deductions and credits for certain activities, none of which are part of the CIT. The change in Michigan tax law required us to remove deferred income tax balances recognized under the MBT and establish new deferred income tax balances under the CIT in the second quarter of 2011. The change in Michigan tax law resulted in a reduction of income tax provision of \$4.6 million during 2011. Additionally, we recorded regulatory assets for this change in tax law as described in Note 5.

### 11. 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 made contributions of \$7.0 million, \$3.6 million and \$6.1 million to the retirement plan in 2012, 2011 and 2010, respectively, although we had no minimum funding requirements. We expect to contribute up to \$6.9 million to the defined benefit retirement plan relating to the 2012 plan year in 2013.

We have also established 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. The obligations under these supplemental nonqualified plans are included in the pension benefit obligation calculations below. The investments in trust for the supplemental nonqualified retirement plans of \$22.4 million and \$16.1 million at December 31, 2012 and 2011, respectively, are not included in the pension plan asset amounts presented below, but are included in other assets on our consolidated statement of financial position. For the years ended December 31, 2012, 2011 and 2010, we contributed \$4.7 million, \$3.1 million and \$0.5 million, respectively, to these supplemental nonqualified, noncontributory, retirement benefit plans. We account for the assets contributed under the supplemental nonqualified, noncontributory, retirement benefit plan and held in a trust as trading securities for certain investments in debt and equity securities per the FASB guidance. Accordingly, realized and unrealized gains or losses on the investments are recorded as investment income or loss. We recognized gains of \$1.9 million, \$2.2 million and \$0.9 million in other income during 2012, 2011 and 2010, respectively, associated with realized and unrealized gains and losses on the investments held in trust associated with our supplemental nonqualified retirement plans.

The plan assets consisted of the following assets by category:

| Asset Category          | 2012  | 2011    |   |
|-------------------------|-------|---------|---|
| Fixed income securities | 48.4  | % 53.1  | % |
| Equity securities       | 51.6  | % 46.9  | % |
| Total                   | 100.0 | % 100.0 | % |





Table of Contents

Net pension cost for 2012, 2011 and 2010 includes the following components:

| (In thousands)                     | 2012    | 2011      | 2010      |
|------------------------------------|---------|-----------|-----------|
| Service cost                       | \$4,160 | \$3,585   | \$2,868   |
| Interest cost                      | 2,590   | 2,458     | 2,222     |
| Expected return on plan assets     | (2,277) | ) (1,896) | ) (1,388) |
| Amortization of prior service cost | (42)    | ) (42)    | ) (42)    |
| Amortization of unrecognized loss  | 3,470   | 2,607     | 1,722     |
| Net pension cost                   | \$7,901 | \$6,712   | \$5,382   |

The following table reconciles the obligations, assets and funded status of the pension plans as well as the amounts recognized as accrued pension liability in the consolidated statement of financial position as of December 31, 2012 and 2011:

| (In thousands)                                   | 2012       | 2011         |
|--|------------|--------------|
| Change in Benefit Obligation:                    |            |              |
| Beginning projected benefit obligation           | \$(56,069) | ) \$(45,104) |
| Service cost                                     | (4,160)    | ) (3,585)    |
| Interest cost                                    | (2,590)    | ) (2,458)    |
| Actuarial net loss                               | (10,481)   | ) (5,861)    |
| Benefits paid                                    | 900        | 939          |
| Ending projected benefit obligation              | \$(72,400) | ) \$(56,069) |
| Change in Plans' Assets:                         |            |              |
| Beginning plan assets at fair value              | \$28,276   | \$24,647     |
| Actual return on plan assets                     | 3,331      | 950          |
| Employer contributions                           | 7,023      | 3,618        |
| Benefits paid                                    | (500)      | ) (939)      |
| Ending plan assets at fair value                 | \$38,130   | \$28,276     |
| Funded status, underfunded                       | \$(34,270) | ) \$(27,793) |
| Ending accumulated benefit obligation            | \$(55,649) | ) \$(46,678) |
| Amounts recorded as:                             |            |              |
| Funded Status:                                   |            |              |
| Accrued pension liabilities                      | \$(35,899) | ) \$(27,793) |
| Pension assets — other assets — other            | 1,629      | —            |
| Total  | \$(34,270) | ) \$(27,793) |
| Unrecognized Amounts in Other Regulatory Assets: |            |              |
| Net actuarial loss                               | \$23,444   | \$17,487     |
| Prior service credit                             | (59)       | ) (101)      |
| Total  | \$23,385   | \$17,386     |

The unrecognized amounts that otherwise would have been charged and or credited to accumulated other comprehensive income associated with the guidance for employers' accounting for pensions are recorded as a regulatory asset on our consolidated statements of financial position as discussed in Note 5.

The amounts recorded as a regulatory asset represent a net periodic benefit cost to be recognized in our operating income in future periods.

Actuarial assumptions used to determine the benefit obligation for 2012, 2011 and 2010 are listed below:

|                                 | 2012         | 2011         | 2010  |
|---------------------------------|--------------|--------------|-------|
| Discount rate                   | 3.70 - 4.45% | 4.50 - 5.00% | 5.60% |
| Annual rate of salary increases | 5.00 - 6.00% | 5.00 - 6.00% | 5.00% |

Table of Contents

Actuarial assumptions used to determine the benefit cost for 2012, 2011 and 2010 are listed below:

|  | 2012         | 2011         | 2010  |
|--|--------------|--------------|-------|
| Discount rate                                    | 4.50 - 5.00% | 5.17 - 5.67% | 6.00% |
| Annual rate of salary increases                  | 5.00 - 6.00% | 5.00 - 6.00% | 5.00% |
| Expected long-term rate of return on plan assets | 7.25%        | 7.25%        | 7.50% |

At December 31, 2012, the projected benefit payments for the defined benefit retirement plan calculated using the same assumptions as those used to calculate the benefit obligation described above are listed below:

(In thousands)

|                   |         |
|-------------------|---------|
| 2013              | \$1,095 |
| 2014              | 1,199   |
| 2015              | 1,275   |
| 2016              | 2,269   |
| 2017              | 4,299   |
| 2018 through 2022 | 23,091  |

#### Investment Objectives and Fair Value Measurement

The general investment objectives of the qualified retirement benefit plan includes maximizing the return within reasonable and prudent levels of risk and controlling administrative and management costs. The targeted asset allocation is weighted equally between equity and fixed income investments. Investment decisions are made by our retirement benefits board as delegated by our board of directors. Equity investments may include various types of U.S. and international equity securities, such as large-cap, mid-cap and small-cap stocks. Fixed income investments may include cash and short-term instruments, U.S. Government securities, corporate bonds, mortgages and other fixed income investments. No investments are prohibited for use in the retirement plan, including derivatives, but our exposure to derivatives currently is not material. We intend that the long-term capital growth of the retirement plan, together with employer contributions, will provide for the payment of the benefit obligations.

We determine our expected long-term rate of return on plan assets based on the current target allocations of the retirement plan investments and considering historical returns on comparable fixed income investments and equity investments.

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.

The fair value measurement of the retirement plan as of December 31, 2012, was as follows:

| (In thousands)   | Fair Value Measurements at Reporting Date Using                |   |   |
|--|--|---|---|
|  | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial assets measured on a recurring basis:            |  |   |   |
| Pooled separate accounts — U.S. equity securities          | \$—  | \$15,702                                      | \$—                                       |
| Pooled separate accounts — international equity securities | —  | 3,979   | —   |
| Pooled separate accounts — fixed income securities         | —  | 15,824  | —   |
| Guaranteed deposit fund                                    | —  | 2,625   | —   |
| Total  | \$—  | \$38,130                                      | \$—                                       |

Table of Contents

The fair value measurement of the retirement plan as of December 31, 2011, was as follows:

| (In thousands)   | Fair Value Measurements at Reporting Date Using                            |  |  |
|--|--|--|--|
|  | Quoted Prices in<br>Active Markets<br>for<br>Identical Assets<br>(Level 1) | Significant<br>Other Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Financial assets measured on a recurring basis:            |  |  |  |
| Pooled separate accounts — U.S. equity securities          | \$—  | \$11,000   | \$—  |
| Pooled separate accounts — international equity securities | —  | 2,270  | —  |
| Pooled separate accounts — fixed income securities         | —  | 13,483   | —  |
| Guaranteed deposit fund                                    | —  | 1,523  | —  |
| Total  | \$—  | \$28,276   | \$—  |

The pooled separate accounts are valued at their estimated fair value by aggregating our proportionate share of the fair value of the underlying securities held by the accounts. The pooled separate accounts investments consist primarily of underlying publicly traded debt and equity securities for which market prices are readily available. The guaranteed deposit fund is a group annuity contract and is valued at estimated fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations that are quoted in active markets.

**Other Postretirement Benefits**

We provide certain postretirement health care, dental, and life insurance benefits for employees who may become eligible for these benefits. We contributed \$4.4 million, \$3.4 million and \$3.1 million to the postretirement benefit plan in 2012, 2011 and 2010, respectively. We expect to contribute up to \$5.5 million to the plan in 2013.

The plan assets consisted of the following assets by category:

| Asset Category          | 2012  | 2011    |  |   |
|-------------------------|-------|---------|--|---|
| Fixed income securities | 49.8  | % 56.4  |  | % |
| Equity securities       | 50.2  | % 43.6  |  | % |
| Total                   | 100.0 | % 100.0 |  | % |

Our measurement of the accumulated postretirement benefit obligation as of December 31, 2012 and 2011 does not reflect the potential receipt of any subsidies under the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

Net postretirement cost for 2012, 2011 and 2010 includes the following components:

| (In thousands)                     | 2012    | 2011    | 2010    |
|------------------------------------|---------|---------|---------|
| Service cost                       | \$5,433 | \$3,431 | \$2,809 |
| Interest cost                      | 1,552   | 1,285   | 984     |
| Expected return on plan assets     | (1,016) | ) (737  | ) (469  |
| Amortization of prior service cost | 125     | 313     | 313     |
| Amortization of unrecognized loss  | 534     | 220     | —       |
| Net postretirement cost            | \$6,628 | \$4,512 |         |