ITC Holdings Corp.
Form 10-Q
August 07, 2008

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

(Mark One)

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

For the Quarterly Period Ended June 30, 2008

OR

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

Commission File Number: 001-32576

ITC HOLDINGS CORP.

(Exact Name of Registrant as Specified in Its Charter)

Michigan	**32-0058047**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

27175 Energy Way
Novi, MI 48377
(Address Of Principal Executive Offices, Including Zip Code)
(248) 946-3000
(Registrant s Telephone Number, Including Area Code)

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

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

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The number of shares of the Registrant s Common Stock, without par value, outstanding as of August 1, 2008 was 49,471,125.

ITC Holdings Corp.
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DEFINITIONS

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

ITC Holdings Corp. and its subsidiaries

ITC 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;

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

METC are references to Michigan Electric Transmission Company, LLC, an indirect, wholly-owned subsidiary of ITC Holdings;

Regulated Operating Subsidiaries are references to ITCTransmission, METC, and ITC Midwest together; and

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

Other definitions

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

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

FERC are references to the Federal Energy Regulatory Commission;

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

IUB are references to the Iowa Utilities Board;

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 regional transmission organization, which oversees the operation of the bulk power transmission system for a substantial portion of the Midwestern United States and Manitoba, Canada, and of which ITCTransmission, METC and ITC Midwest are members;

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

NERC are references to the North American Electric Reliability Corporation.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
ITC HOLDINGS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

(in thousands, except share data)	June 30, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 13,400	$ 2,616
Accounts receivable	55,854	40,919
Inventory	22,786	26,315
Deferred income taxes	12,910	2,689
Other	5,876	3,518
Total current assets	110,826	76,057
Property, plant and equipment (net of accumulated depreciation and amortization of $898,729 and $879,843, respectively)	2,114,617	1,960,433
Other assets		
Goodwill	960,071	959,042
Intangible assets (net of accumulated amortization of $4,537 and $3,025, respectively)	53,870	55,382
Regulatory assets- acquisition adjustments	83,359	86,054
Regulatory assets- Attachment O revenue accrual (including accrued interest of $1,141 and $552, respectively)	72,492	20,537
Other regulatory assets	29,732	29,449
Deferred financing fees (net of accumulated amortization of $6,981 and $5,138, respectively)	20,656	14,201
Other	21,441	12,142
Total other assets	1,241,621	1,176,807
TOTAL ASSETS	$ 3,467,064	$ 3,213,297
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 63,493	$ 47,627
Accrued payroll	7,915	8,928
Accrued interest	37,970	23,088
Accrued taxes	22,647	15,065
ITC Midwest s asset acquisition additional purchase price accrual	4,960	5,402
Refundable deposits from generators for transmission network upgrades	9,902	2,352
Other	3,811	3,965
Total current liabilities	150,698	106,427
Accrued pension and postretirement liabilities	16,515	13,934
Deferred income taxes	135,917	90,617
Regulatory liabilities	193,500	189,727

Other	4,490	6,093
Long-term debt	2,065,652	2,243,424
STOCKHOLDERS EQUITY		
Common stock, without par value, 100,000,000 shares authorized, 49,463,885 and 42,916,852 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively	843,777	532,103
Retained earnings	57,375	31,864
Accumulated other comprehensive loss	(860)	(892)
Total stockholders equity	900,292	563,075
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 3,467,064	$ 3,213,297

See notes to condensed consolidated financial statements (unaudited).

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

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except share and per share data)	2008	2007	2008	2007
OPERATING REVENUES	$ 160,616	$ 106,303	$ 302,530	$ 207,577
OPERATING EXPENSES				
Operation and maintenance	32,902	21,503	54,357	40,043
General and administrative	21,361	12,203	39,343	27,226
Depreciation and amortization	23,446	16,711	45,770	32,833
Taxes other than income taxes	10,313	8,066	21,198	16,836
Gain on sale of asset	(1,445)		(1,445)	
Total operating expenses	86,577	58,483	159,223	116,938
OPERATING INCOME	74,039	47,820	143,307	90,639
OTHER EXPENSES (INCOME)				
Interest expense	29,946	19,940	60,716	39,072
Allowance for equity funds used during construction	(2,284)	(1,613)	(5,380)	(2,853)
Loss on extinguishment of debt				349
Other income	(552)	(1,018)	(1,062)	(1,720)
Other expense	597	336	1,434	669
Total other expenses (income)	27,707	17,645	55,708	35,517
INCOME BEFORE INCOME TAXES	46,332	30,175	87,599	55,122
INCOME TAX PROVISION	17,671	10,176	33,417	18,268
NET INCOME	$ 28,661	$ 19,999	$ 54,182	$ 36,854
Basic earnings per share	$ 0.58	$ 0.47	$ 1.13	$ 0.87
Diluted earnings per share	$ 0.57	$ 0.46	$ 1.10	$ 0.85
Weighted-average basic shares	49,002,365	42,269,646	48,153,011	42,180,993
Weighted-average diluted shares	50,205,625	43,424,029	49,355,024	43,432,526
Dividends declared per common share	$ 0.290	$ 0.275	$ 0.580	$ 0.550

See notes to condensed consolidated financial statements (unaudited).

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

	Six months ended June 30,	
(in thousands)	**2008**	**2007**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 54,182	$ 36,854
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	45,770	32,833
Attachment O revenue accrual including accrued interest	(51,946)	(23,541)
Deferred income tax expense	32,564	18,268
Allowance for equity funds used during construction	(5,380)	(2,853)
Stock-based compensation expense	3,220	1,622
Amortization of loss on reacquired debt, deferred financing fees and debt discounts	3,075	2,190
Other	(1,435)	(76)
Changes in assets and liabilities, exclusive of changes shown separately:		
Accounts receivable	(13,623)	(14,703)
Inventory	1,783	(10,256)
Other current assets	(2,358)	5,893
Accounts payable	15,969	14,922
Accrued interest	14,882	727
Accrued taxes	7,582	1,513
Other current liabilities	(1,502)	(5,599)
Non-current assets and liabilities, net	(1,639)	1,288
Net cash provided by operating activities	101,144	59,082
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(193,793)	(148,162)
ITC Midwest s asset acquisition direct fees	(981)	(1,459)
Other	1,445	926
Net cash used in investing activities	(193,329)	(148,695)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	657,782	
Borrowings under ITC Holdings Term Loan Agreement		25,000
Repayment of long-term debt	(765,000)	
Borrowings under revolving credit agreements	282,500	293,300
Repayments of revolving credit agreements	(353,200)	(209,600)
Issuance of common stock	309,427	1,759
Common stock issuance costs	(755)	(5)
Dividends on common stock	(28,662)	(23,363)
Repurchase and retirement of common stock		(1,841)
Debt issuance costs	(5,409)	(565)
Refundable deposits from generators for transmission network upgrades	6,286	
Net cash provided by financing activities	102,969	84,685
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	10,784	(4,928)
CASH AND CASH EQUIVALENTS Beginning of period	2,616	13,426

CASH AND CASH EQUIVALENTS End of period	$	13,400	$	8,498

See notes to condensed consolidated financial statements (unaudited).

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. GENERAL

These condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements as of and for the period ended December 31, 2007 included in ITC Holdings Form 10-K for such period.

The accompanying condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States of America (GAAP) and with the instructions to Form 10-Q and Rule 10-01 of Securities and Exchange Commission (SEC) Regulation S-X as they apply to interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These accounting principles require us to use estimates and assumptions that impact the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results may differ from our estimates.

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

Supplementary Cash Flows Information

	Six months ended June 30,	
(in thousands)	**2008**	**2007**
Supplementary cash flows information:		
Interest paid (excluding interest capitalized)	$42,758	$36,505
Income taxes paid	1,314	2,058
Supplementary noncash investing and financing activities:		
Additions to property, plant and equipment (a)	35,772	26,472
Allowance for equity funds used during construction	5,380	2,853

(a) Amounts consist primarily 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 June 30, 2008 or 2007, respectively, but have been or will be included as a cash outflow from

investing
activities for
expenditures for
property, plant
and equipment
when paid.

Comprehensive Income

Comprehensive income is the change in stockholders equity during a period from transactions and other events and circumstances from non-owner sources.

Comprehensive income includes the following components:

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	**2008**	**2007**	**2008**	**2007**
Net income	$ 28,661	$ 19,999	$ 54,182	$ 36,854
Amortization of interest rate lock cash flow hedges, net of tax of $9 for the three months ended June 30, 2008 and 2007, respectively, and net of tax of $17 for the six months ended June 30, 2008 and 2007, respectively	16	16	32	32
Comprehensive income	$ 28,677	$ 20,015	$ 54,214	$ 36,886

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2. RECENT ACCOUNTING PRONOUNCEMENTS

FASB Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities

In June 2008, the Financial Accounting Standards Board (the FASB) issued FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities as defined in EITF 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128*, and therefore should be included in computing earnings per share using the two-class method. According to FSP EITF 03-6-1, a share-based payment award is a participating security when the award includes non-forfeitable rights to dividends or dividend equivalents. The rights result in a non-contingent transfer of value each time an entity declares a dividend or dividend equivalent during the award s vesting period. FSP EITF 03-6-1 is effective for us beginning January 1, 2009. Upon adoption, FSP EITF 03-6-1 requires an entity to retroactively adjust all prior period earnings-per-share computations to reflect the FSP s provisions. We have share-based payment awards that include non-forfeitable rights to dividends and we are evaluating the future impact of FSP EITF 03-6-1 on our earnings-per-share computations.

Statement of Financial Accounting Standards No. 141(R), Business Combinations

Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (SFAS 141(R)) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination. Certain provisions of SFAS 141(R) will, among other things, impact the determination of acquisition-date fair value of consideration paid in a business combination (including contingent consideration), exclude transaction costs from acquisition accounting and require expense recognition for these costs and change accounting practices for acquired contingencies, acquisition-related restructuring costs, in-process research and development, indemnification assets, and tax benefits. SFAS 141(R) is effective for us for business combinations occurring beginning January 1, 2009 and for adjustments to an acquired entity s deferred tax asset and liability balances occurring beginning January 1, 2009. We are evaluating the future impact of SFAS 141(R).

Statement of Financial Accounting Standards No. 157, Fair Value Measurements

Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. We have adopted SFAS 157 and FASB Staff Position FAS157-2: *Effective Date of FASB Statement No. 157* effective January 1, 2008. The adoption of SFAS 157 for financial instruments as required at January 1, 2008 did not have a material effect on our consolidated financial statements; however, we are required to provide additional disclosure as part of our consolidated financial statements. We will adopt SFAS 157 for non-financial assets and non-financial liabilities, such as goodwill and other intangible assets held by us and measured annually for impairment testing purposes only, on January 1, 2009 as required and do not expect the provisions to have a material effect on our consolidated financial statements.

SFAS 157 establishes a three-tier fair value 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.

As of June 30, 2008, we held certain assets that are required to be measured at fair value on a recurring basis. These consist of investments recorded within other long-term assets, including investments held in trust associated with our nonqualified, noncontributory, supplemental retirement benefit plans for selected management and employees that are classified as trading securities under Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Our investments consist primarily of mutual funds and debt and equity securities that are publicly traded and for which market prices are readily available.

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Our assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS 157 at June 30, 2008, were as follows:

	Fair Value Measurements at Reporting Date Using		
(in thousands)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Trading securities	$ 6,285	$	$

Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)

Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158), requires the recognition of the funded status of a defined benefit plan in the statement of financial position as other comprehensive income. Additionally, SFAS 158 requires that changes in the funded status be recognized through comprehensive income, requires the measurement date for defined benefit plan assets and obligations to be the entity s fiscal year-end and expands disclosures. Upon adoption of SFAS 158 we applied the provisions of Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* and the amounts that otherwise would have been charged and or credited to accumulated other comprehensive income associated with Statement of Financial Accounting Standards No. 87, *Employers Accounting for Pensions* (SFAS 87), and Statement of Financial Accounting Standards No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions* (SFAS 106), are recorded as a regulatory asset or liability because as the unrecognized amounts recorded to this regulatory asset are recognized through SFAS 87 and SFAS 106 expenses, under forward-looking Attachment O, they will be recovered from customers in future rates.

Under the provisions of SFAS 158, we recognized the funded status of our defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of the SFAS 158 funded status recognition and disclosure provisions did not have an impact on our condensed consolidated results of operations or cash flows.

Under the measurement date requirements of SFAS 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer s fiscal year-end statement of financial position. Historically, we have measured our plan assets and obligations as of a date three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. In 2008, we are required to adopt the change in measurement date by allocating as an adjustment to retained earnings three-fifteenths of net periodic benefit cost as determined for the period from September 30, 2007 to December 31, 2008, pursuant to the transition requirements of SFAS 158. We expect this to result in a decrease in other long-term assets of $0.3 million, an increase in total liabilities of $0.5 million (consisting of a $0.9 million increase in accrued pension and postretirement liabilities offset by a $0.4 million decrease in deferred income tax liabilities) and a $0.8 million (net of tax of a $0.4 million) decrease in retained earnings, which we expect to record in the fourth quarter of 2008. The remaining twelve-fifteenths of net periodic benefit cost of $4.6 million will be recognized during the fiscal year ending December 31, 2008.

Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities

Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), was issued in February 2007. SFAS 159 allows entities to measure at fair value many financial instruments and certain other assets and liabilities that are not otherwise required to be measured at fair value. SFAS 159 was effective for us beginning January 1, 2008. The adoption of this statement did not have a

material effect on our consolidated financial statements.

Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133

Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS 161) amends and expands the disclosure requirements of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), by requiring enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and how derivative instruments and related hedged items affect an

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entity s financial position, financial performance, and cash flows. SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 will be effective for us as of January 1, 2009. The adoption of this standard will not have a material impact on our consolidated financial statements because SFAS 161 provides only for disclosure requirements.

Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles

Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162), was issued in May 2008. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS 162 will become effective for us 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The adoption of this standard is not expected to have a material impact on our consolidated financial statements.

3. ACQUISITIONS, GOODWILL AND INTANGIBLE ASSETS

ITC Midwest s Acquisition of IP&L Transmission Assets

On December 20, 2007, ITC Midwest acquired the electric transmission assets of IP&L, for $783.1 million, excluding fees, expenses and purchase price adjustments, pursuant to an asset sale agreement, dated January 18, 2007, with IP&L (the Asset Sale Agreement). The purchase price is subject to several purchase price adjustment provisions relating to liabilities actually assumed by ITC Midwest and the actual rate base, construction work in progress and other asset or liability balances actually transferred to ITC Midwest by IP&L on December 20, 2007.

ITC Midwest s asset acquisition was accounted for as an acquisition of a group of assets that constitutes a business under the provisions of Statement of Financial Accounting Standards No. 141, *Business Combinations*. As of June 30, 2008, the purchase price and purchase price allocation has not been finalized. At June 30, 2008, ITC Midwest has recorded $5.0 million in current liabilities for additional purchase price estimated to be paid relating to certain revisions to the original estimated assets acquired and liabilities assumed. We had recorded an estimate of $5.4 million in current liabilities for additional purchase price to be paid at December 31, 2007.

ITC Midwest also incurred $12.3 million for professional services and other direct acquisition costs in connection with the acquisition, resulting in an aggregate estimated purchase price of $800.4 million as of June 30, 2008. ITC Midwest had recorded an estimate of $11.7 million of professional services and other direct acquisition costs at December 31, 2007. The additional $0.6 million of direct acquisition costs recorded during the six months ended June 30, 2008 are included in the aggregate purchase price and resulted in an increase in goodwill.

In addition, as a condition of the Asset Sale Agreement we assumed $1.7 million of prior service obligations for participants who transferred from IP&L to us for postretirement benefits. As of December 31, 2007, we had not recorded a liability for these obligations as they were expected to be fully funded by IP&L. However, during the first quarter of 2008, IP&L only paid us $1.3 million associated with these obligations based on their obligations under the Asset Sale Agreement. The difference of $0.4 million resulted in an increase to goodwill during the six months ended June 30, 2008.

Intangible Assets

We have identified intangible assets with finite lives as a result of the METC acquisition in 2006. During both the six months ended June 30, 2008 and 2007, we recognized $1.5 million of amortization expense of our intangible assets and we expect to amortize $3.0 million of our intangible assets per year over the five years from 2008 through 2012, and $40.4 million thereafter.

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4. REGULATORY MATTERS

Attachment O Network Transmission Rates

Attachment O is a FERC-approved cost of service formula rate template that is completed annually by most transmission owning members of MISO, including each of our Regulated Operating Subsidiaries. Rates are generally set annually under Attachment O and remain in effect for a one-year period. Rates derived using Attachment O are posted on the MISO Open Access Same-Time Information System each year. The information used to complete the Attachment O template is subject to verification by MISO. By completing the Attachment O template 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, operating expenses and additions to property, plant and equipment when placed in service, among other items.

Because Attachment O is a FERC-approved formula rate, no further action or FERC filings are required for the calculated rates to go into effect, although the rate is subject to legal challenge at the FERC. Attachment O will be used by our Regulated Operating Subsidiaries to calculate their respective annual revenue requirements until and unless it is determined by the FERC to be unjust and unreasonable or another mechanism is determined by the FERC to be just and reasonable.

Forward-Looking Attachment O

On July 14, 2006 and December 21, 2006, the FERC authorized ITCTransmission and METC, respectively, to modify the implementation of their Attachment O formula rates so that, beginning January 1, 2007, ITCTransmission and METC recover expenses and earn a return on and recover investments in property, plant and equipment on a current rather than a lagging basis. As part of the FERC order dated December 3, 2007 approving ITC Midwest s asset acquisition, the FERC approved ITC Midwest s request for the use of a forward-looking Attachment O. The compliance filing we made for ITC Midwest s forward-looking Attachment O is pending at FERC.

Under the forward-looking Attachment O formula, our Regulated Operating Subsidiaries use forecasted expenses, additions to in-service property, plant and equipment, point-to-point revenues, network load and other items for the upcoming calendar year to establish rates for service on their systems from January 1 to December 31 of that year. The forward-looking Attachment O formula includes a true-up mechanism, whereby our Regulated Operating Subsidiaries compare their actual net revenue requirements to their billed revenues for each year.

The true-up mechanism under forward-looking Attachment O meets the requirements of Emerging Issues Task Force Issue No. 92-7, *Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs*, (EITF 92-7). Accordingly, revenue is recognized for services provided during each reporting period based on actual net revenue requirements calculated using forward-looking Attachment O. Beginning January 1, 2007, ITCTransmission and METC accrued or deferred revenues to the extent that the actual net 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 forward-looking Attachment O.

For the period from December 20, 2007 through December 31, 2007, ITC Midwest s Attachment O method in effect did not contain a true-up mechanism, and there was no adjustment recognized for billed amounts that differed from actual net revenue requirement. Beginning January 1, 2008, under forward-looking Attachment O, ITC Midwest recovers its expenses and earns a return on and recovers investments in transmission property, plant and equipment on a current rather than a lagging basis and includes a true-up mechanism.

Long Term Pricing

In November 2004, in FERC Docket No. EL02-111 et al., the FERC approved a pricing structure to facilitate seamless trading of electricity between MISO and PJM Interconnection, a Regional Transmission Organization that borders MISO. The order establishes a Seams Elimination Cost Adjustment (SECA), as set forth in previous FERC orders, that took effect December 1, 2004, and remained in effect until March 31, 2006 as a transitional pricing mechanism. Prior to December 1, 2004, ITCTransmission and METC earned revenues for transmission of electricity between MISO and PJM Interconnection based on a regional through-and-out rate administered by MISO.

From December 1, 2004 through March 31, 2006, we recorded $2.5 million of gross SECA revenue based on an allocation of these revenues by MISO as a result of the FERC order approving this transitional pricing mechanism. Subsequent to the first quarter of 2006, we no longer earn SECA revenues. The SECA revenues were subject to refund as described in the FERC order and this matter was litigated in a contested hearing before the FERC that concluded on May 18, 2006. An initial decision was issued by the Administrative Law Judge presiding over the hearings on August 10, 2006, which generally indicated that the SECA revenues resulted from unfair, unjust and preferential rates. The judge s decision is subject to the FERC s final ruling on the matter, which could differ from the initial decision. Notwithstanding the judge s initial decision, ITCTransmission, METC and other transmission owners who collected SECA amounts and certain counterparties that paid SECA amounts have filed settlement agreements with the FERC. As of June 30, 2008, ITCTransmission and METC have reserves recorded of $0.6 million and $0.4 million, respectively, as estimates of the amounts to be refunded to the counterparties that have filed settlement agreements with the FERC. For the counterparties who have not filed settlements with the FERC, we are not able to estimate whether any refunds of amounts earned by ITCTransmission or METC will result from this hearing or whether this matter will otherwise be settled, but we do not expect the resolution of this matter to have a material impact on our consolidated financial statements. We have not accrued any refund amounts relating to these counterparties who have not filed settlements with the FERC.

5. LONG-TERM DEBT

ITC Midwest s Asset Acquisition Debt Financing

ITC Holdings Bridge Facility

ITC Holdings received a commitment letter, dated January 18, 2007, from a bank (the Lead Arranger) to provide to ITC Holdings, subject to the terms and conditions therein, financing in an aggregate amount of up to $765.0 million in the form of a 364-day senior unsecured bridge facility (the Bridge Facility). Among other fees paid on the Bridge Facility, ITC Holdings paid a funding fee equal to 0.375% of the aggregate amount of the loans borrowed (the Funding Fee). The Funding Fee was rebated in full in January 2008 as a result of the Bridge Facility being refinanced with the Lead Arranger within the specified time period, and was applied as a reduction to the issuance costs of ITC Midwest s asset acquisition financings. The borrowings under the Bridge Facility accrued interest at 5.56% and total interest expense recognized in 2008 was $2.7 million. The proceeds from the Bridge Facility were used to finance a significant portion of ITC Midwest s asset acquisition.

In January 2008, we repaid in full all amounts outstanding under the Bridge Facility using the proceeds of ITC Holdings $385.0 million Senior Notes, ITC Midwest s $175.0 million First Mortgage Bonds, Series A and the issuance of 6,420,737 shares of ITC Holdings common stock for proceeds of $308.3 million, net of underwriting discount. The terms of the ITC Holdings Senior Notes and ITC Midwest First Mortgage Bonds are discussed below.

ITC Holdings Senior Notes

On January 24, 2008, ITC Holdings issued $385.0 million aggregate principal amount of its 6.050% Senior Notes due January 31, 2018 under its first mortgage indenture, dated as of December 10, 2003 in a private placement in reliance on exemptions from registration under the Securities Act of 1933. The senior notes were sold by ITC Holdings to various initial purchasers pursuant to a purchase agreement dated January 15, 2008. The proceeds were used to partially pay off the balance of the Bridge Facility.

ITC Midwest First Mortgage Bonds

On January 24, 2008, ITC Midwest issued $175.0 million aggregate principal amount of its 6.150% First Mortgage Bonds, Series A, due January 31, 2038 (Series A Bonds).

The Series A Bonds are secured by a first mortgage lien on substantially all of ITC Midwest s real and tangible personal property equally with all other securities issued in the future under its First Mortgage and Deed of Trust, with such exceptions as described in, and such releases as permitted by, the indenture. The proceeds were used to partially pay off the balance of the Bridge Facility.

ITCTransmission First Mortgage Bonds

On April 1, 2008, ITCTransmission issued $100.0 million aggregate principal amount of its 5.75% First Mortgage Bonds, Series D, due April 18, 2018 (Series D Bonds). The Series D 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. The proceeds were primarily used to pay off amounts outstanding under the ITCTransmission/METC Revolving Credit Agreement.

Revolving Credit Agreements

ITC Holdings Revolving Credit Agreement

At June 30, 2008, ITC Holdings had no amounts outstanding under the ITC Holdings Revolving Credit Agreement.

ITCTransmission/METC Revolving Credit Agreement

At June 30, 2008, ITCTransmission and METC had $8.9 million and $40.5 million, respectively, outstanding under the ITCTransmission/METC Revolving Credit Agreement and the weighted-average interest rates of borrowings outstanding under the agreement at June 30, 2008 were 2.8% and 3.0%, respectively. On April 1, 2008, we repaid the outstanding balance of $91.1 million at ITCTransmission using the proceeds from the Series D Bonds issuance.

ITC Midwest Revolving Credit Agreement

At June 30, 2008, ITC Midwest had $22.4 million outstanding under the ITC Midwest Revolving Credit Agreement and the weighted-average interest rate of borrowings outstanding under the facility at June 30, 2008 was 3.0%.

6. EQUITY

ITC Holdings Sales Agency Financing Agreement

On June 27, 2008, ITC Holdings entered into a Sales Agency Financing Agreement (the SAFE Agreement) with BNY Mellon Capital Markets, LLC (BNYMCM). Under the terms of the SAFE Agreement, ITC Holdings may issue and sell shares of common stock, without par value, from time to time, up to an aggregate sales price of $150.0 million. The terms of the SAFE Agreement will be for a period of up to three years subject to continued approval from the FERC authorizing ITC Holdings to issue equity. BNYMCM will act as ITC Holdings agent in connections with any offerings of shares under the SAFE Agreement. The shares of common stock may be offered in one or more selling periods, none of which will exceed 20 trading days. Any shares of common stock sold under the SAFE Agreement will be offered at market prices prevailing at the time of sale. Moreover, ITC Holdings will specify to BNYMCM (i) the aggregate selling price of the shares of common stock to be sold during each selling period, which may not exceed $40.0 million without BYNMCM s prior written consent and (ii) the minimum price below which sales may not be made, which may not be less than $10.00 per share without BNYMCM s prior written consent. ITC Holdings will pay BNYMCM a commission equal to 1% of the sales price of all shares of common stock sold through it as agent under the SAFE Agreement plus expenses. The shares will be issued pursuant to ITC Holdings automatic shelf registration statement on Form S-3 (File No. 333-140026) filed on January 17, 2007 with the SEC.

Public Securities Offering

On January 24, 2008, ITC Holdings completed an underwritten public offering of its common stock. ITC Holdings sold 6,420,737 newly-issued common shares in the offering, which resulted in proceeds of $308.3 million (net of underwriting discount of $13.7 million and before issuance costs of $0.8 million). The proceeds from this offering were used to partially finance ITC Midwest s asset acquisition described in Note 3.

Options

We issued 92,072 and 351,172 shares of our common stock during the six months ended June 30, 2008 and the year ended
December 31, 2007, respectively, due to the exercise of stock options.

7. EARNINGS PER SHARE

We report both basic and diluted earnings per share. Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share assumes the issuance of

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potentially dilutive shares of common stock during the period resulting from the exercise of common stock options and vesting of restricted stock awards. A reconciliation of both calculations for the three and six months ended June 30, 2008 and 2007 is presented in the following table:

	Three months ended June 30,		Six months ended June 30,	
(in thousands, except share and per share data)	**2008**	**2007**	**2008**	**2007**
Basic earnings per share:				
Net income	$ 28,661	$ 19,999	$ 54,182	$ 36,854