

ITC Holdings Corp.  
Form 10-Q  
August 06, 2014

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

(Mark One)

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

For the Quarterly Period Ended June 30, 2014

OR

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

Commission File Number: 001-32576

ITC HOLDINGS CORP.

(Exact Name of Registrant as Specified in Its Charter)

Michigan

(State or Other Jurisdiction of Incorporation or  
Organization)

32-0058047

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

27175 Energy Way

Novi, MI 48377

(Address Of Principal Executive Offices, Including Zip Code)

(248) 946-3000

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

Yes  No

The number of shares of the Registrant's Common Stock, without par value, outstanding as of August 1, 2014 was 155,585,300.

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DEFINITIONS

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

ITC Holdings Corp. and its subsidiaries

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

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

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

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

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

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

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

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

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

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

Other definitions

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

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

“Entergy Transaction” are references to the transaction whereby the electric transmission business of Entergy Corporation was to be separated and subsequently merged with a wholly-owned subsidiary of ITC Holdings. The proposed transaction was terminated in December 2013;

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

“FPA” are references to the Federal Power Act;

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

“ITC Holdings’ annual report on Form 10-K” are references to the annual report on Form 10-K filed on February 27, 2014;

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

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

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

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

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

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

“RTO” are references to Regional Transmission Organizations; and

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

EXPLANATORY NOTE

Unless otherwise noted, the share and per share data in this Form 10-Q reflects the three-for-one stock split effective February 28, 2014.

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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, 2014	December 31, 2013
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$9,017	\$34,275
Accounts receivable	123,483	89,348
Inventory	29,375	31,986
Deferred income taxes	18,806	17,225
Regulatory assets — revenue accruals, including accrued interest	4,728	6,334
Prepaid and other current assets	21,994	12,370
Total current assets	207,403	191,538
Property, plant and equipment (net of accumulated depreciation and amortization of \$1,340,464 and \$1,330,094, respectively)	5,203,707	4,846,526
Other assets		
Goodwill	950,163	950,163
Intangible assets (net of accumulated amortization of \$23,259 and \$21,616, respectively)	49,614	49,328
Other regulatory assets	184,310	179,068
Deferred financing fees (net of accumulated amortization of \$14,027 and \$15,261, respectively)	29,516	25,585
Other	56,212	40,035
Total other assets	1,269,815	1,244,179
<b>TOTAL ASSETS</b>	<b>\$6,680,925</b>	<b>\$6,282,243</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$126,859	\$111,145
Accrued payroll	16,562	21,930
Accrued interest	51,098	53,049
Accrued taxes	40,674	29,805
Regulatory liabilities — revenue deferrals, including accrued interest	35,336	33,120
Refundable deposits from generators for transmission network upgrades	20,780	23,283
Debt maturing within one year	250,000	200,000
Other	19,606	27,047
Total current liabilities	560,915	499,379
Accrued pension and postretirement liabilities	56,913	53,704
Deferred income taxes	624,549	562,938
Regulatory liabilities — revenue deferrals, including accrued interest	29,951	36,447
Regulatory liabilities — accrued asset removal costs	67,192	67,571
Refundable deposits from generators for transmission network upgrades	4,884	19,328
Other	20,867	17,032
Long-term debt	3,755,495	3,412,112
Commitments and contingent liabilities (Note 11)		
<b>STOCKHOLDERS' EQUITY</b>	<b>882,845</b>	<b>1,014,435</b>

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Common stock, without par value, 300,000,000 shares authorized, 155,512,734 and 157,500,795 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively

Retained earnings	671,459	592,970
Accumulated other comprehensive income	5,855	6,327
Total stockholders' equity	1,560,159	1,613,732
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$6,680,925</b>	<b>\$6,282,243</b>

See notes to condensed consolidated financial statements (unaudited).

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands, except per share data)	Three months ended		Six months ended	
	June 30, 2014	2013	June 30, 2014	2013
OPERATING REVENUES	\$263,214	\$229,817	\$521,817	\$447,121
OPERATING EXPENSES				
Operation and maintenance	25,836	29,668	50,697	54,181
General and administrative	30,308	43,939	58,270	78,865
Depreciation and amortization	31,295	29,295	62,673	57,781
Taxes other than income taxes	17,076	16,094	38,269	32,764
Other operating (income) and expenses — net	(229)	(173)	(461)	(345)
Total operating expenses	104,286	118,823	209,448	223,246
OPERATING INCOME	158,928	110,994	312,369	223,875
OTHER EXPENSES (INCOME)				
Interest expense — net	45,854	40,402	91,163	79,465
Allowance for equity funds used during construction	(4,932)	(8,292)	(9,944)	(17,025)
Loss on extinguishment of debt	29,074	—	29,074	—
Other income	(236)	(286)	(397)	(495)
Other expense	1,625	2,671	2,958	3,681
Total other expenses (income)	71,385	34,495	112,854	65,626
INCOME BEFORE INCOME TAXES	87,543	76,499	199,515	158,249
INCOME TAX PROVISION	33,207	29,104	76,043	60,664
NET INCOME	\$54,336	\$47,395	\$123,472	\$97,585
Basic earnings per common share	\$0.34	\$0.30	\$0.78	\$0.62
Diluted earnings per common share	\$0.34	\$0.30	\$0.78	\$0.62
Dividends declared per common share	\$0.1425	\$0.1258	\$0.2850	\$0.2516

See notes to condensed consolidated financial statements (unaudited).

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## ITC HOLDINGS CORP. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)	Three months ended		Six months ended	
	June 30, 2014	2013	June 30, 2014	2013
NET INCOME	\$54,336	\$47,395	\$123,472	\$97,585
OTHER COMPREHENSIVE INCOME				
Derivative instruments, net of tax (Note 6)	(688	) 22,252	(582	) 24,358
Available-for-sale securities, net of tax (Note 6)	60	—	110	—
TOTAL OTHER COMPREHENSIVE INCOME, NET OF TAX	(628	) 22,252	(472	) 24,358
TOTAL COMPREHENSIVE INCOME	\$53,708	\$69,647	\$123,000	\$121,943

See notes to condensed consolidated financial statements (unaudited).

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)	Six months ended	
	June 30,	2013
	2014	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$123,472	\$97,585
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	62,673	57,781
Recognition, refund and collection of revenue accruals and deferrals — including accrued interest	(7,248	) (14,074
Deferred income tax expense	56,978	50,537
Allowance for equity funds used during construction	(9,944	) (17,025
Loss on extinguishment of debt	29,074	—
Other	8,142	7,287
Changes in assets and liabilities, exclusive of changes shown separately:		
Accounts receivable	(28,890	) (28,368
Inventory	2,611	157
Prepaid and other current assets	(9,623	) (3,630
Accounts payable	(21,394	) 14,944
Accrued payroll	(3,524	) (2,989
Accrued interest	(1,951	) 15,049
Accrued taxes	10,869	7,444
Other current liabilities	(9,370	) 4,403
Other non-current assets and liabilities, net	(5,903	) (4,269
Net cash provided by operating activities	195,972	184,832
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Expenditures for property, plant and equipment	(375,650	) (422,295
Other	235	(3,839
Net cash used in investing activities	(375,415	) (426,134
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of long-term debt	473,664	100,000
Borrowings under revolving credit agreements	1,054,100	638,900
Borrowings under term loan credit agreements	110,000	350,000
Retirement of long-term debt — including debt retirement costs	(198,494	) —
Repayments of revolving credit agreements	(1,035,300	) (767,400
Repayments under term loan credit agreements	(39,000	) —
Issuance of common stock	14,177	6,073
Dividends on common and restricted stock	(44,983	) (39,522
Refundable deposits from generators for transmission network upgrades	5,208	16,770
Repayment of refundable deposits from generators for transmission network upgrades	(22,155	) (24,125
Repurchase and retirement of common stock	(107,952	) (4,040
Forward contract of accelerated share repurchase program	(46,000	) —
Other	(9,080	) 2,304
Net cash provided by financing activities	154,185	278,960
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	(25,258	) 37,658
<b>CASH AND CASH EQUIVALENTS — Beginning of period</b>	34,275	26,187
<b>CASH AND CASH EQUIVALENTS — End of period</b>	\$9,017	\$63,845

See notes to condensed consolidated financial statements (unaudited).





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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 1. GENERAL

These condensed consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements as of and for the year ended December 31, 2013 included in ITC Holdings' annual report on Form 10-K for such period.

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

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

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

## Supplementary Cash Flows Information

	Six months ended	
	June 30,	
(in thousands)	2014	2013
Supplementary cash flows information:		
Interest paid (net of interest capitalized)	\$90,248	\$62,692
Income taxes paid — net	25,416	11,593
Supplementary non-cash investing and financing activities:		
Additions to property, plant and equipment (a)	\$105,246	\$99,485
Allowance for equity funds used during construction	9,944	17,025

Amounts consist of current liabilities for construction labor and materials that have not been included in investing (a) activities. These amounts have not been paid for as of June 30, 2014 or 2013, respectively, but have been or will be included as a cash outflow from investing activities for expenditures for property, plant and equipment when paid.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

## Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued authoritative guidance requiring entities to apply a new model for recognizing revenue from contracts with customers. The guidance will supersede the current revenue recognition guidance and require entities to evaluate their revenue recognition arrangements using a five step model to determine when a customer obtains control of a transferred good or service. The guidance is effective for annual reporting periods beginning after December 15, 2016 and may be adopted using a full or modified retrospective application. We are currently in the process of evaluating our revenue arrangements under the issued guidance and have not yet determined its impact to our results of operations, cash flows and financial position.

## 3. REGULATORY MATTERS

## Start-Up, Development and Pre-Construction Regulatory Assets

As of June 30, 2014, we have recorded a total of \$14.0 million of regulatory assets for start-up, development and pre-construction expenses, including associated carrying charges, incurred by ITC Great Plains, which include certain costs incurred for the Kansas Electric Transmission Authority ("KETA") Project and the Kansas V-Plan Project prior to construction. ITC Great Plains made a filing with the FERC under Section 205 of the FPA in May 2013 to recover these start-up, development and pre-construction expenses, including associated carrying charges, in future rates. If FERC authorization is received, ITC Great Plains will include the unamortized balance of the regulatory assets in its rate base and will amortize them over a 10-year period beginning at the later of the project in-service date or the FERC authorization date. The amortization expense will be recovered through ITC Great Plains' cost-based formula

rate template beginning in the period in which amortization begins.

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## Order on Formula Rate Protocols

In 2012, the FERC issued an order initiating a proceeding pursuant to Section 206 of the FPA to determine whether the formula rate protocols under the MISO Tariff are sufficient to ensure just and reasonable rates. Our MISO Regulated Operating Subsidiaries were named in the order. In May 2013, the FERC issued an order that determined the formula rate protocols are insufficient to ensure just and reasonable rates and directed MISO and its member transmission owners (“TOs”) to file revised formula rate protocols. In September 2013, MISO and its TOs, including our MISO Regulated Operating Subsidiaries, filed revised formula rate protocols which will require our MISO Regulated Operating Subsidiaries to provide additional information for certain aspects of the formula rates used to calculate their respective annual revenue requirements. On March 20, 2014, FERC issued an order conditionally accepting MISO and its TOs’ September 2013 filing and required a further compliance filing, which MISO and its TOs made on May 19, 2014. We do not expect the revised formula rate protocols to impact our results of operations, cash flows or financial condition.

## FERC Audit Refund

See “FERC Audit Refund” in Note 11 for a discussion of the FERC audit refund.

## Rate of Return on Equity and Capital Structure Complaint

See “Rate of Return on Equity and Capital Structure Complaint” in Note 11 for a discussion of the complaint.

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

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

Our cost-based formula rate templates include a true-up mechanism, whereby our Regulated Operating Subsidiaries compare their actual revenue requirements to their billed revenues for each year to determine any over- or under-collection of revenue requirements. The over- or under-collection typically results from differences between the projected revenue requirement used to establish the billing rate and actual revenue requirement at each of our Regulated Operating Subsidiaries, or from differences between actual and projected monthly peak loads at our MISO Regulated Operating Subsidiaries. Revenue is recognized for services provided during each reporting period based on actual revenue requirements calculated using the formula rate templates. Our Regulated Operating Subsidiaries accrue or defer revenues to the extent that the actual revenue requirement for the reporting period is higher or lower, respectively, than the amounts billed relating to that reporting period. The amount of accrued or deferred revenues is reflected in customer bills within two years under the provisions of the formula rate templates.

The current and non-current regulatory assets are recorded in the condensed consolidated statements of financial position in regulatory assets — revenue accruals, including accrued interest and other non-current assets, respectively. The current and non-current regulatory liabilities are recorded in regulatory liabilities — revenue deferrals, including accrued interest. The net changes in regulatory assets and liabilities associated with our Regulated Operating Subsidiaries’ formula rate revenue accruals and deferrals, including accrued interest, were as follows during the six months ended June 30, 2014:

(in thousands)	Total
Balance as of December 31, 2013	\$(60,196 )
Net refund of 2012 revenue deferrals and accruals, including accrued interest	13,629
Net revenue deferral for the six months ended June 30, 2014	(5,348 )
Net accrued interest payable for the six months ended June 30, 2014	(1,033 )
Balance as of June 30, 2014	\$(52,948 )



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

(in thousands)	Total
Current assets	\$4,728
Non-current assets — other	7,611
Current liabilities	(35,336 )
Non-current liabilities	(29,951 )
Balance as of June 30, 2014	\$(52,948 )

#### 4. GOODWILL AND INTANGIBLE ASSETS

##### Goodwill

At June 30, 2014 and December 31, 2013, 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

We have recorded intangible assets as a result of the METC acquisition in 2006. The carrying value of these assets was \$35.7 million and \$37.2 million (net of accumulated amortization of \$22.7 million and \$21.2 million) as of June 30, 2014 and December 31, 2013, respectively.

We have also recorded intangible assets for payments and obligations made by ITC Great Plains to certain TOs to acquire rights which are required under the SPP tariff to designate ITC Great Plains to build, own and operate projects within the SPP region, including the KETA Project and the Kansas V-Plan Project. The carrying amount of these intangible assets was \$13.9 million and \$12.1 million (net of accumulated amortization of \$0.6 million and \$0.4 million) as of June 30, 2014 and December 31, 2013, respectively.

During the three months ended June 30, 2014 and 2013, we recognized \$0.8 million of amortization expense of our intangible assets and \$1.6 million for the six months ended June 30, 2014 and 2013. For each of the next five years, we expect the annual amortization of our intangible assets that have been recorded as of June 30, 2014 to be \$3.3 million per year.

#### 5. DEBT

##### Derivative Instruments and Hedging Activities

We may use derivative financial instruments, including interest rate swap contracts, to manage our exposure to fluctuations in interest rates. The use of these financial instruments mitigates exposure to these risks and the variability of our operating results. We are not a party to leveraged derivatives and do not enter into derivative financial instruments for trading or speculative purposes. In May 2014, we executed, settled and terminated \$150.0 million of 10-year interest rate swaps in conjunction with the Senior Notes issued at ITC Holdings described below. A summary of the terminated interest rate swaps is provided below:

Interest Rate Swaps	Amount	Weighted Average Fixed Rate of Interest Rate Swaps	Comparable Reference Rate of Senior Notes	Loss on Derivative	Settlement Date
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(amounts in millions)

10-year interest rate swaps	\$150.0	2.65%	2.53%	\$1.6	May 2014
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The interest rate swaps qualified for hedge accounting treatment and the loss of \$1.6 million was recognized as of June 30, 2014 for the effective portion of the hedges and recorded net of tax in accumulated other comprehensive income ("AOCI"). This amount will be amortized as a component of interest expense over the lives of the related debt. As of June 30, 2014 and December 31, 2013, we had no outstanding derivative financial instruments.

##### ITC Holdings

On December 20, 2013, ITC Holdings entered into an unsecured, unguaranteed term loan credit agreement, due September 30, 2016, with an initial borrowing capacity of \$200.0 million. As of June 30, 2014 and December 31, 2013, ITC Holdings



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had \$161.0 million and \$140.0 million outstanding under this agreement, respectively. The proceeds were used for general corporate purposes, including the repayment of borrowings under the ITC Holdings' revolving credit agreement. The weighted-average interest rate on the borrowing outstanding under this agreement was 1.3% at June 30, 2014.

On May 2, 2014, ITC Holdings commenced a cash tender offer for any and all of the outstanding \$255.0 million ITC Holdings 5.875% Senior Notes due September 30, 2016 and \$255.0 million ITC Holdings 6.375% Senior Notes due September 30, 2036, under which \$115.6 million of the 5.875% Senior Notes and \$54.7 million of the 6.375% Senior Notes were validly tendered on May 30, 2014. All of the Senior Notes validly tendered were subsequently retired with the proceeds from the \$400.0 million 3.65% Senior Notes described below. ITC Holdings incurred a loss on extinguishment of debt of \$29.1 million related to the tender premium and the write-off of deferred debt issuance costs and other expenses.

On May 28, 2014, ITC Holdings issued \$400.0 million aggregate principal amount of its 3.65% Senior Notes, due June 15, 2024. The proceeds from the issuance were used for the cash tender offer described above and for general corporate purposes, primarily the repayment of borrowings under the ITC Holdings revolving credit agreement. The ITC Holdings Senior Notes are issued under its indenture. All issuances of ITC Holdings Senior Notes are unsecured. ITCTransmission

On June 10, 2014, ITCTransmission issued \$75.0 million of 4.27% First Mortgage Bonds, Series F, due June 10, 2044 ("First Mortgage Bonds"). ITCTransmission also agreed to issue an additional \$25.0 million of First Mortgage Bonds in August 2014 with terms and conditions identical to those of the First Mortgage Bonds. The proceeds from the June issuance were used for general corporate purposes, primarily the repayment of borrowings under the ITCTransmission revolving credit agreement. All of ITCTransmission's First Mortgage Bonds are issued under its First Mortgage and Deed of Trust and secured by a first mortgage lien on substantially all of its property.

## METC

On January 31, 2014, METC entered into an unsecured, unguaranteed term loan credit agreement, under which METC borrowed the maximum of \$50.0 million available under the agreement. The proceeds were used for general corporate purposes, primarily the repayment of borrowings under the METC revolving credit agreement. The term loan is scheduled to mature on February 2, 2015. The weighted average interest rate on the borrowings outstanding under the term loan was 1.2% at June 30, 2014.

## Revolving Credit Agreements

On March 28, 2014, ITC Holdings and its Regulated Operating Subsidiaries entered into new unsecured, unguaranteed revolving credit agreements maturing in March 2019, which replaced their existing revolving credit agreements. At June 30, 2014, ITC Holdings and its Regulated Operating Subsidiaries had the following unsecured revolving credit facilities available:

(amounts in millions)	Total Available Capacity	Outstanding Balance (a)	Unused Capacity	Weighted Average Interest Rate on Outstanding Balance		Commitment Fee Rate (b)	
ITC Holdings	\$400.0	\$—	\$400.0	n/a	(c)	0.175	%
ITCTransmission	100.0	16.1	83.9	1.1%	(d)	0.10	%
METC	100.0	42.3	57.7	1.1%	(d)	0.10	%
ITC Midwest	250.0	146.1	103.9	1.2%	(d)	0.10	%
ITC Great Plains	150.0	85.5	64.5	1.3%	(e)	0.125	%
Total	\$1,000.0	\$290.0	\$710.0				

(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.

(c)



Loan would bear interest at a rate equal to LIBOR plus an applicable margin of 1.25% or at a base rate, which is defined as the higher of the prime rate, 0.50% above the federal funds rate or 1% above the one month LIBOR, plus an applicable margin of 0.25%, subject to adjustments based on ITC Holdings' credit rating.

Loans bear interest at a rate equal to LIBOR plus an applicable margin of 1.00% or at a base rate, which is defined (d) as the higher of the prime rate, 0.50% above the federal funds rate or 1% above the one month LIBOR, subject to adjustments based on the borrower's credit rating.

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Loan bears interest at a rate equal to LIBOR plus an applicable margin of 1.125% or at a base rate, which is defined (e) as the higher of the prime rate, 0.50% above the federal funds rate or 1% above the one month LIBOR, plus an applicable margin of 0.125%, subject to adjustments based on the borrower's credit rating.

## Covenants

Our debt instruments contain numerous financial and operating covenants that place significant restrictions on certain transactions, such as incurring additional indebtedness, engaging in sale and lease-back transactions, creating liens or other encumbrances, entering into mergers, consolidations, liquidations or dissolutions, creating or acquiring subsidiaries, selling or otherwise disposing of all or substantially all of our assets and paying dividends. In addition, the covenants require us to meet certain financial ratios, such as maintaining certain debt to capitalization ratios and maintaining certain interest coverage ratios. As of June 30, 2014, we were in compliance with all debt covenants.

## 6. STOCKHOLDERS' EQUITY

The changes in stockholders' equity for the six months ended June 30, 2014 were as follows:

(in thousands, except share and per share data)	Common Stock		Retained	Accumulated	Total
	Shares	Amount	Earnings	Other Comprehensive Income	Stockholders' Equity
BALANCE, DECEMBER 31, 2013	157,500,795	\$ 1,014,435	\$ 592,970	\$ 6,327	\$ 1,613,732
Net income	—	—	123,472	—	123,472
Repurchase and retirement of common stock	(3,013,176 )	(107,952 )	—	—	(107,952 )
Dividends declared on common stock (\$0.2850 per share)	—	—	(44,983 )	—	(44,983 )
Stock option exercises	761,321	13,172	—	—	13,172
Shares issued under the Employee Stock Purchase Plan	34,594	1,004	—	—	1,004
Issuance of restricted stock	289,793	—	—	—	—
Forfeiture of restricted stock	(60,593 )	—	—	—	—
Share-based compensation, net of forfeitures	—	8,186	—	—	8,186
Forward contract of accelerated share repurchase program	—	(46,000 )	—	—	(46,000 )
Other comprehensive income, net of tax	—	—	—	(472 )	(472 )
BALANCE, JUNE 30, 2014	155,512,734	\$ 882,845	\$ 671,459	\$ 5,855	\$ 1,560,159

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

(in thousands, except share and per share data)	Common Stock		Retained	Accumulated	Total
	Shares	Amount	Earnings	Other Comprehensive Income (Loss)	Stockholders' Equity
BALANCE, DECEMBER 31, 2012	156,745,542	\$ 989,334	\$ 443,569	\$ (18,048 )	\$ 1,414,855
Net income	—	—	97,585	—	97,585
Repurchase and retirement of common stock	(136,317 )	(4,040 )	—	—	(4,040 )
Dividends declared on common stock (\$0.2516 per share)	—	—	(39,522 )	—	(39,522 )
Stock option exercises	346,653	5,164	—	—	5,164
Shares issued under the Employee Stock Purchase Plan	39,858	909	—	—	909
Issuance of restricted stock	348,138	—	—	—	—
Forfeiture of restricted stock	(17,007 )	—	—	—	—
Share-based compensation, net of forfeitures	—	7,517	—	—	7,517

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Other comprehensive income, net of tax	—	—	—	24,358	24,358
BALANCE, JUNE 30, 2013	157,326,867	\$998,884	\$501,632	\$6,310	\$1,506,826

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## Accumulated Other Comprehensive Income

The following table provides the components of changes in AOCI for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three months ended		Six months ended	
	June 30, 2014	2013	June 30, 2014	2013
Balance at the beginning of period	\$6,483	\$(15,942)	\$6,327	\$(18,048)
Derivative instruments				
Reclassification of net loss relating to interest rate cash flow hedges from AOCI to interest expense — net (net of tax of \$79 and \$9 for the three months ended June 30, 2014 and 2013, respectively, and net of tax of \$155 and \$19 for the six months ended June 30, 2014 and 2013, respectively)	112	15	218	29
Reclassification of loss relating to interest rate cash flow hedges from AOCI to loss on extinguishment of debt (net of tax of \$83 for the three and six months ended June 30, 2014)	117	—	117	—
Gain (loss) on interest rate swaps relating to interest rate cash flow hedges (net of tax of \$14,287 and \$15,652 for the three and six months ended June 30, 2013, respectively, and \$655 for the three and six months ended June 30, 2014)	(917)	) 22,237	(917)	) 24,329
Derivative instruments, net of tax	(688)	) 22,252	(582)	) 24,358
Available-for-sale securities				
Unrealized net gain on available-for-sale securities (net of tax of \$43 and \$79 for the three and six months ended June 30, 2014, respectively)	60	—	110	—
Available-for-sale securities, net of tax	60	—	110	—
Total other comprehensive income, net of tax	(628)	) 22,252	(472)	) 24,358
Balance at the end of period	\$5,855	\$6,310	\$5,855	\$6,310

## Stock Split

In January 2014, we filed an amendment to our Articles of Incorporation, as previously approved by our shareholders, to increase the number of authorized shares of common stock to 300 million shares. On February 6, 2014, our board of directors declared a three-for-one split of our common stock to be accomplished by means of a stock distribution on February 28, 2014 to shareholders of record on February 18, 2014. As a result of the stock split and other issuances and retirements during the six months ended June 30, 2014, our outstanding shares increased from approximately 52.5 million shares as of December 31, 2013 to 155.5 million shares as of June 30, 2014. In addition, all unvested restricted stock awards, outstanding stock option awards and share reserves under our share-based compensation plans as discussed in Note 7 were adjusted under the terms of the respective agreements for this three-for-one split. The share and per share data in this Form 10-Q reflects the three-for-one stock split effective February 28, 2014, unless otherwise noted.

## Accelerated Share Repurchase Program

On June 19, 2014, ITC Holdings entered into an accelerated share repurchase agreement of up to \$150.0 million (minimum of \$130.0 million) with JP Morgan Chase (“JP Morgan”) (the “ASR program”), which is part of the Board of Directors authorized share repurchase program for up to \$250.0 million approved in April 2014 and expiring in December 2015. Under the ASR program, ITC Holdings paid \$150.0 million to JP Morgan and received an initial delivery of 2.9 million shares with a fair market value of \$104.0 million, based on the closing market price of \$35.80 per share at the commencement of the ASR program. The final number of shares delivered under the ASR program

will be based on the volume-weighted average share price of our common stock during the term of the transaction, less an agreed upon discount and adjusted for the initial share delivery. The ASR program is expected to be completed by the end of 2014.

The \$46.0 million unsettled portion of the ASR program meets the criteria to be accounted for as a forward contract indexed to our stock and qualifies as an equity instrument. ITC Holdings recorded the \$150.0 million payment as a reduction to common stock, which included the \$104.0 million of initial shares repurchased and the unsettled forward contract of \$46.0 million as

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of June 30, 2014. The initial delivery of shares resulted in an immediate reduction to our common stock outstanding used to calculate our earnings per share disclosed in Note 8.

ITC Holdings Sales Agency Financing Agreement

On July 27, 2011, ITC Holdings entered into a Sales Agency Financing Agreement with Deutsche Bank Securities Inc. as sales agent (the "SAFA"). Under the terms of the SAFA, ITC Holdings was able to issue and sell shares of common stock, without par value, from time to time, up to an aggregate sales proceeds amount of \$250.0 million. No shares were issued under the SAFA prior to its expiration on July 27, 2014.

7. SHARE-BASED COMPENSATION

Long-Term Incentive Plan Grants

On May 20, 2014, pursuant to the Second Amended and Restated 2006 Long-Term Incentive Plan ("LTIP"), we granted 652,900 options to purchase shares of our common stock with an exercise price of \$36.73 per share, which was the closing price of our common stock on the date of grant. The options vest in three equal annual installments with the first installment vesting on May 20, 2015. In addition, on May 20, 2014, pursuant to the LTIP, we granted 259,014 shares of restricted stock at a fair value of \$36.73 per share. Holders of restricted stock have all the rights of a holder of common stock of ITC Holdings, including dividend and voting rights. The restricted stock vests three years after the grant date. The holder of the restricted stock may not sell, transfer or pledge their shares of restricted stock until vesting occurs.

Stock Option Exercises

We issued 761,321 and 499,014 shares of our common stock during the six months ended June 30, 2014 and the year ended December 31, 2013, respectively, due to the exercise of stock options.

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## 8. EARNINGS PER SHARE

We report both basic and diluted earnings per share. Our restricted stock and deferred stock units contain rights to receive nonforfeitable dividends and thus, are participating securities requiring the two-class method of computing earnings per share. A reconciliation of both calculations for the three and six months ended June 30, 2014 and 2013 is presented in the following table (see additional information below under “Stock Split” for the recast share and per share data for the three and six months ended June 30, 2013 as a result of the three-for-one stock split):

	Three months ended June 30,		Six months ended June 30,		
(in thousands, except share, per share data and percentages)	2014	2013	2014	2013	
Numerator:					
Net income	\$54,336	\$47,395	\$123,472	\$97,585	
Less: dividends declared and paid — common and restricted shares	(22,530)	(19,789)	(44,983)	(39,522)	)
Undistributed earnings	31,806	27,606	78,489	58,063	
Percentage allocated to common shares (a)	99.2	% 99.0	% 99.2	% 99.0	%
Undistributed earnings — common shares	31,552	27,331	77,861	57,482	
Add: dividends declared and paid — common shares	22,347	19,605	44,609	39,143	
Numerator for basic and diluted earnings per common share	\$53,899	\$46,936	\$122,470	\$96,625	
Denominator:					
Basic earnings per common share — weighted average common shares outstanding	156,427,493	155,645,337	156,309,340	155,458,851	
Incremental shares for stock options and employee stock purchase plan — weighted average assumed conversion	1,541,565	1,288,170	1,523,485	1,222,989	
Diluted earnings per common share — adjusted weighted average shares and assumed conversion	157,969,058	156,933,507	157,832,825	156,681,840	
Per common share net income:					
Basic	\$0.34	\$0.30	\$0.78	\$0.62	
Diluted	\$0.34	\$0.30	\$0.78	\$0.62	

(a) Weighted average common shares outstanding	156,427,493	155,645,337	156,309,340	155,458,851	
Weighted average restricted shares (participating securities)	1,297,578	1,509,081	1,329,136	1,534,395	
Total	157,725,071	157,154,418	157,638,476	156,993,246	
Percentage allocated to common shares	99.2	% 99.0	% 99.2	% 99.0	%

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

	2014	2013
Outstanding stock options and ESPP shares (as of June 30)	4,891,913	5,374,689
Anti-dilutive stock options and ESPP shares (for the three and six months ended June 30)	654,231	942,333





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## Stock Split

Below are the effects of the stock split on earnings per share for the three and six months ended June 30, 2013:  
(in thousands, except per share and share data)

For the three months ended June 30, 2013

	Reported	Adjustment	Adjusted
Numerator for basic and diluted earnings per common share	\$46,936	\$—	\$46,936
Denominator:			
Basic earnings per common share — weighted average common shares	51,881,779	103,763,558	155,645,337
Incremental shares for stock options and employee stock purchase plan	429,390	858,780	1,288,170
Diluted earnings per common share — adjusted weighted average shares and assumed conversion	52,311,169	104,622,338	156,933,507
Per common share net income:			
Basic	\$0.90	\$(0.60)	) \$0.30
Diluted	\$0.90	\$(0.60)	) \$0.30

For the six months ended June 30, 2013

Numerator for basic and diluted earnings per common share	\$96,625	\$—	\$96,625
Denominator:			
Basic earnings per common share — weighted average common shares	51,819,617	103,639,234	155,458,851
Incremental shares for stock options and employee stock purchase plan	407,663	815,326	1,222,989
Diluted earnings per common share — adjusted weighted average shares and assumed conversion	52,227,280	104,454,560	156,681,840
Per common share net income:			
Basic	\$1.86	\$(1.24)	) \$0.62
Diluted	\$1.85	\$(1.23)	) \$0.62

Below are the effects of the stock split on other disclosures included for earnings per share for the three and six months ended June 30, 2013:

## Percentage Allocated to Common Shares

	Reported	Adjustment	Adjusted
For the three months ended June 30, 2013			
Weighted-average common shares outstanding	51,881,779	103,763,558	155,645,337
Weighted-average restricted shares (participating securities)	503,027	1,006,054	1,509,081
Total	52,384,806	104,769,612	157,154,418
Percentage allocated to common shares	99.0	% —	% 99.0
For the six months ended June 30, 2013			
Weighted-average common shares outstanding	51,819,617	103,639,234	155,458,851
Weighted-average restricted shares (participating securities)	511,465	1,022,930	1,534,395
Total	52,331,082	104,662,164	156,993,246
Percentage allocated to common shares	99.0	% —	% 99.0

## Outstanding and Anti-dilutive Stock Options and ESPP Shares

The outstanding stock options and the ESPP shares as of June 30, 2013 and the anti-dilutive stock options and ESPP shares excluded from the diluted earnings per share calculations for the three and six months ended June 30, 2013

were as follows:

	Reported June 30, 2013	Adjustment	Adjusted June 30, 2013
Outstanding stock options and ESPP shares	1,791,563	3,583,126	5,374,689
Anti-dilutive stock options and ESPP shares	314,111	628,222	942,333

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## Impacts of the Accelerated Share Repurchase Program

The basic shares outstanding as of June 30, 2014 include the impacts of the initial delivery of 2.9 million shares received under the ASR, as described in Note 6. The forward contract component of the ASR of \$46.0 million is excluded from the diluted earnings per share calculation for the three and six months ended June 30, 2014 based on the volume-weighted average price calculated as of June 30, 2014, which results in an anti-dilutive impact on earnings per share. The final settlement amount may increase or decrease earnings per share at the settlement date depending upon the volume-weighted average share price of our common stock during the term of the transaction.

## 9. RETIREMENT BENEFITS AND ASSETS HELD IN TRUST

## Retirement Plan Benefits

We have a qualified retirement plan for eligible employees, comprised of a traditional final average pay plan and a cash balance plan. The traditional final average pay plan is noncontributory, covers select employees, and provides retirement benefits based on 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. Our funding practice for the qualified retirement plan is to contribute amounts necessary to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974, plus additional amounts as we determine appropriate. During the second quarter of 2014, we contributed \$3.8 million to the defined benefit retirement plan. We do not expect to make any additional contributions to this plan in 2014.

We also have two supplemental nonqualified, noncontributory, retirement benefit plans for selected management employees. The plans provide for benefits that supplement those provided by our other retirement plans. We contributed \$5.1 million to these supplemental nonqualified, noncontributory, retirement benefit plans during the second quarter of 2014. We do not expect to make any additional contributions to these plans in 2014.

Net pension cost, by component, was as follows for the three and six months ended June 30, 2014:

(in thousands)	Three months ended		Six months ended	
	June 30, 2014	2013	June 30, 2014	2013
Service cost	\$1,267	\$1,316	\$2,533	\$2,631
Interest cost	901	633	1,802	1,396
Expected return on plan assets	(885)	(717)	(1,770)	(1,434)
Amortization of prior service credit	(11)	(11)	(21)	(21)
Amortization of unrecognized loss	386	678	772	1,357
Net pension cost	\$1,658	\$1,899	\$3,316	\$3,929

## Other Postretirement Benefits

We provide certain postretirement health care, dental, and life insurance benefits for eligible employees. During the second quarter of 2014, we contributed \$1.2 million to the postretirement benefit plan. We expect to make an estimated additional contribution of \$5.0 million to the postretirement benefit plan during the second half of 2014.

Net postretirement cost, by component, was as follows for the three and six months ended June 30, 2014:

(in thousands)	Three months ended		Six months ended	
	June 30, 2014	2013	June 30, 2014	2013
Service cost	\$1,462	\$1,444	\$2,923	\$2,887
Interest cost	498	391	996	781
Expected return on plan assets	(341)	(355)	(681)	(708)
Amortization of unrecognized loss	—	55	—	110
Net postretirement cost	\$1,619	\$1,535	\$3,238	\$3,070

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## Defined Contribution Plan

We also sponsor a defined contribution retirement savings plan. Participation in this plan is available to substantially all employees. We match employee contributions up to certain predefined limits based upon eligible compensation and the employee's contribution rate. The cost of this plan was \$0.8 million and \$0.7 million for the three months ended June 30, 2014 and 2013, respectively, and \$2.1 million and \$2.4 million for the six months ended June 30, 2014 and 2013, respectively.

## 10. FAIR VALUE MEASUREMENTS

The measurement of fair value is based on a three-tier hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. For the six months ended June 30, 2014 and the year ended December 31, 2013, there were no transfers between levels.

Our assets measured at fair value subject to the three-tier hierarchy at June 30, 2014, were 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:			
Cash and cash equivalents — cash equivalents	\$3,625	\$—	\$—
Mutual funds — fixed income securities	26,657	—	—
Mutual funds — equity securities	636	—	—
Total	\$30,918	\$—	\$—

Our assets measured at fair value subject to the three-tier hierarchy at December 31, 2013, were 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:			
Cash and cash equivalents — cash equivalents	\$19,000	\$—	\$—
Mutual funds — fixed income securities	21,318	—	—
Mutual funds — equity securities	516	—	—
Total	\$40,834	\$—	\$—

As of June 30, 2014 and December 31, 2013, we held certain assets and liabilities that are required to be measured at fair value on a recurring basis. The assets consist of investments recorded within cash and cash equivalents and other long-term assets, including investments held in a trust associated with our supplemental nonqualified, noncontributory, retirement benefit plans for selected management employees. Our cash and cash equivalents consist of money market mutual funds that are administered similar to money market funds recorded at cost plus accrued interest to approximate fair value. Our mutual funds consist primarily of publicly traded mutual funds and are recorded at fair value based on observable trades for identical securities in an active market. Changes in the observed trading prices and liquidity of money market funds are monitored as additional support for determining fair value, and losses are recorded in earnings for investment classified as trading securities and other comprehensive income for

investments classified as available for sale if fair value falls below recorded cost.

We also held non-financial assets that are required to be measured at fair value on a non-recurring basis. These consist of goodwill and intangible assets. We did not record any impairment charges on long-lived assets and no other significant events occurred requiring non-financial assets and liabilities to be measured at fair value (subsequent to initial recognition) during the six months ended June 30, 2014. For additional information on our goodwill and intangible assets, please refer to the notes to the consolidated financial statements as of and for the year ended December 31, 2013 included in our Form 10-K for such period and to Note 4 of this Form 10-Q.

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Fair Value of Financial Assets and Liabilities

Fixed Rate Debt

Based on the borrowing rates obtained from third party lending institutions currently available for bank loans with similar terms and average maturities from active markets, the fair value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,709.7 million and \$3,299.0 million at June 30, 2014 and December 31, 2013, respectively. These fair values represent Level 2 under the three-tier hierarchy described above. The total book value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,404.5 million and \$3,100.9 million at June 30, 2014 and December 31, 2013, respectively.

Revolving and Term Loan Credit Agreements

At June 30, 2014 and December 31, 2013, we had a consolidated total of \$601.0 million and \$511.2 million, respectively, outstanding under our revolving and term loan credit agreements, which are variable rate loans. The fair value of these loans approximates book value based on the borrowing rates currently available for variable rate loans obtained from third party lending institutions. These fair values represent Level 2 under the three-tier hierarchy described above.

Other Financial Instruments

The carrying value of other financial instruments included in current assets and current liabilities, including cash and cash equivalents and special deposits, approximates their fair value due to the short-term nature of these instruments.

11. COMMITMENTS AND CONTINGENT LIABILITIES

Environmental Matters

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

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

Some properties in which our Regulated Operating Subsidiaries have an ownership interest or at which they operate are, and others are suspected of being, affected by environmental contamination. Our Regulated Operating Subsidiaries are not aware of any pending or threatened claims against them with respect to environmental

contamination, or of any investigation or remediation of contamination at any properties, that entail costs likely to materially affect them. Some facilities and properties are located near environmentally sensitive areas such as wetlands.

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

### Litigation

We are involved in certain legal proceedings before various courts, governmental agencies and mediation panels concerning matters arising in the ordinary course of business. These proceedings include certain contract disputes, regulatory matters and pending judicial matters. We cannot predict the final disposition of such proceedings. We regularly review legal matters and record provisions for claims that are considered probable of loss.

### Michigan Sales and Use Tax Audit

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

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

The amount of the potential use tax liability associated with the exemptions taken by ITCTransmission through June 30, 2014 is estimated to be approximately \$19.7 million for periods still subject to audit, which includes approximately \$3.9 million assessed for the audit period April 1, 2005 through June 30, 2008, including interest. ITCTransmission has not recorded this contingent liability as of June 30, 2014. However, in the event it becomes appropriate to record additional use tax liability relating to this matter, ITCTransmission would record the additional use tax primarily as an increase to the cost of property, plant and equipment, as the majority of purchases for which the exemption was taken relate to equipment purchases associated with capital projects. METC has also taken the industrial processing exemption, estimated to be approximately \$10.9 million for periods still subject to audit; however, METC has not recorded any contingent liabilities as of June 30, 2014 associated with this matter. These higher use tax expenses would be included as components of net revenue requirements and resulting rates.

### FERC Audit Refund

The FERC issued an order that identified certain findings and recommendations of certain staff of the FERC relating to specific aspects of the accounting treatment for the acquisition of the transmission assets of IP&L by ITC Midwest that requires adjustments to the MISO Regulated Operating Subsidiaries' respective annual revenue requirement calculations and corresponding refunds. The amounts are being refunded through the cost-based formula rates in 2014. ITC Midwest, ITCTransmission and METC have recorded an aggregate regulatory liability for the refund and related interest of \$6.6 million and \$13.1 million as of June 30, 2014 and December 31, 2013, respectively, in the condensed consolidated statements of financial position.

### ITC Midwest Project Commitment

In the Minnesota regulatory proceeding to approve ITC Midwest's December 2007 acquisition of the transmission assets of IP&L, ITC Midwest agreed to build a certain project in Iowa, the 345 kV Salem-Hazelton line, and made a commitment to use commercially reasonable best efforts to complete the project prior to December 31, 2011. In the event ITC Midwest is found to have failed to meet this commitment, the allowed 12.38% rate of return on the actual equity portion of its capital structure would be reduced to 10.39% until such time as ITC Midwest completes the project, and ITC Midwest would refund with interest any amounts collected since the close date of the transaction that exceeded what would have been collected if the 10.39% return on equity had been used. Certain regulatory approvals were needed from the Iowa Utilities Board ("IUB") before construction of the project could commence, but due to the IUB's case schedule, these approvals were not received until the second quarter of 2011. As a result of the delay in the



receipt of the necessary regulatory approvals, the project was not completed by December 31, 2011. We have notified the Minnesota Public Utilities Commission that the Salem-Hazleton

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line was placed into service on April 25, 2013, and requested confirmation from the commission that ITC Midwest has satisfied its commitment and that no refund is due as a result of the project not being completed by December 31, 2011. We believe we used commercially reasonable best efforts to meet the December 31, 2011 deadline, and therefore, we believe the likelihood of any material effect on the financial statements from this matter is remote.

**Rate of Return on Equity and Capital Structure Complaint**

On November 12, 2013, Association of Businesses Advocating Tariff Equity, Coalition of MISO Transmission Customers, Illinois Industrial Energy Consumers, Indiana Industrial Energy Consumers, Inc., Minnesota Large Industrial Group, and Wisconsin Industrial Energy Group (the “joint complainants”) filed a complaint with the FERC under Section 206 of the FPA, requesting that the FERC find the regional base rate of return on equity (“ROE”) for all MISO TOs, including ITCTransmission, METC and ITC Midwest (currently set at 12.38%) to be unjust and unreasonable. The joint complainants are seeking a FERC order reducing the base regional ROE used in our formula transmission rate to 9.15%. The complaint also alleges that the rates of any MISO TO using a capital structure with greater than 50% for the equity component are likewise not just and reasonable (ITCTransmission, METC and ITC Midwest use their actual capital structures, which FERC has approved at a target of 60% equity). The complaint asks FERC to institute a uniform capital structure for MISO TOs in which the assumed equity component does not exceed 50%. The complaint also alleges the ROE adders currently approved for certain ITC operating companies, including adders currently utilized by ITCTransmission for being a member of an RTO and adders utilized by ITCTransmission and METC for being an independent transmission owner, are no longer just and reasonable, and seeks to have them eliminated. In the event a refund is required upon resolution of the complaint, the joint complainants are seeking a refund effective date of November 12, 2013.

On January 6, 2014, ITCTransmission, METC and ITC Midwest filed responses with the FERC to the Section 206 complaint (jointly with other MISO TOs and through a separate supplemental response), defending the use of the current regional base ROE, the use of current capital structures, and the approved ROE adders for RTO membership and independence. The responses seek dismissal of the complaint, or a denial of it on merits, with prejudice, as the joint complainants failed to meet their burden under Section 206 of the FPA to show that the current regional base ROE, approved capital structures and ROE adders approved for ITCTransmission and METC are no longer just and reasonable. Further, the responses argue that the current ROE, approved capital structures and adders encourage transmission investment, are especially appropriate given the benefits of the independent transmission company model and RTO membership and provide testimony to demonstrate that they remain just and reasonable.

On June 19, 2014, in a separate but related Section 206 complaint against certain ISO New England TOs, FERC adopted a new method for establishing ROEs for electric transmission utilities. The new method is based on a two-step process and uses both short-term and long-term growth projections in establishing ROEs, whereas the previous method used only short-term growth projections. Under this new method, FERC also reiterated its policy of capping the overall ROE, including adders, at the high end of the zone of reasonableness set by the two-step discounted cash flow (“DCF”) methodology. We expect the new method presented in the ISO New England ROE case will also be used in resolving the MISO ROE case.

It is reasonably possible that the refund exposure for a potential reduction to the ROEs of our MISO Regulated Operating Subsidiaries could result in a material impact on our results of operations, cash flows and financial condition. The range of potential impact of this matter to our consolidated results of operations, cash flows and financial condition is not estimable due to the uncertainty of the calculation of an authorized ROE along with the zone of reasonableness, which is directly affected by the newly adopted two-step DCF methodology. The ROEs to be established would be dependent on the appropriate proxy group and assumptions for short and long-term growth rates at the time the ROE is ultimately determined. There is additional uncertainty as to the effective date of any potential refund period. As of June 30, 2014, our MISO Regulated Operating Subsidiaries had a total of approximately \$2.5 billion of equity in their capital structures for ratemaking purposes. Based on this level of aggregate equity, we estimate that each 10 basis point reduction in the authorized ROE would reduce annual consolidated net income by approximately \$2.5 million. We continue to believe the likelihood of an unfavorable outcome of the complaint as it relates to the request to modify our existing capital structures is remote.



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## 12. SEGMENT INFORMATION

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

	Three months ended		Six months ended	
	June 30,		June 30,	
(in thousands)	2014	2013	2014	2013
<b>OPERATING REVENUES:</b>				
Regulated Operating Subsidiaries	\$263,303	\$229,891	\$521,996	\$447,271
ITC Holdings and other	92	152	184	304
Intercompany eliminations	(181 )	(226 )	(363 )	(454 )
<b>Total Operating Revenues</b>	<b>\$263,214</b>	<b>\$229,817</b>	<b>\$521,817</b>	<b>\$447,121</b>
	Three months ended		Six months ended	
	June 30,		June 30,	
(in thousands)	2014	2013	2014	2013
<b>INCOME BEFORE INCOME TAXES:</b>				
Regulated Operating Subsidiaries	\$147,187	\$125,199	\$288,779	\$244,459
ITC Holdings and other	(59,644 )	(48,700 )	(89,264 )	(86,210 )
<b>Total Income Before Income Taxes</b>	<b>\$87,543</b>	<b>\$76,499</b>	<b>\$199,515</b>	<b>\$158,249</b>
	Three months ended		Six months ended	
	June 30,		June 30,	
(in thousands)	2014	2013	2014	2013
<b>NET INCOME:</b>				
Regulated Operating Subsidiaries	\$90,296	\$78,121	\$176,849	\$151,877
ITC Holdings and other	54,336	47,395	123,472	97,585
Intercompany eliminations	(90,296 )	(78,121 )	(176,849 )	(151,877 )
<b>Total Net Income</b>	<b>\$54,336</b>	<b>\$47,395</b>	<b>\$123,472</b>	<b>\$97,585</b>
<b>TOTAL ASSETS:</b>			June 30,	December
(in thousands)			2014	31,
Regulated Operating Subsidiaries			\$6,577,523	\$6,174,888
ITC Holdings and other			3,810,270	3,619,759
Reconciliations / Intercompany eliminations (a)			(3,706,868 )	(3,512,404 )
<b>Total Assets</b>			<b>\$6,680,925</b>	<b>\$6,282,243</b>

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

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

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

Our reports, filings and other public announcements contain certain statements that describe our management's beliefs concerning future business conditions, plans and prospects, growth opportunities and the outlook for our business and the electric transmission industry based upon information currently available. Such statements are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. Wherever possible, we have identified these forward-looking statements by words such as "will," "may," "anticipates," "believes," "intends," "estimates," "expects," "projects," "likely" and similar phrases. These forward-looking statements are based upon assumptions our management believes are reasonable. Such forward-looking statements are subject to risks and uncertainties which could cause our actual results, performance and achievements to differ materially from those expressed in, or implied by, these statements, including, among others, the risks and uncertainties listed in Item 1A Risk Factors of our Form 10-K for the fiscal year ended December 31, 2013, and the following:

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

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

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

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

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

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

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

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

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

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

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



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• Acts of war, terrorist attacks, cyber attacks, natural disasters, severe weather and other catastrophic events may have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

• We have a considerable amount of debt and our reliance on debt financing may limit our ability to fulfill our debt obligations and/or to obtain additional financing.

• Certain provisions in our debt instruments limit our financial and operating flexibility.

• Adverse changes in our credit ratings may negatively affect us.

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

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

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

## OVERVIEW

Through our Regulated Operating Subsidiaries, we operate high-voltage systems in Michigan's Lower Peninsula and portions of Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma that transmit electricity from generating stations to local distribution facilities connected to our systems. Our business strategy is to operate, maintain and invest in transmission infrastructure in order to enhance system integrity and reliability, to reduce transmission constraints and to upgrade the transmission networks to support new generating resources interconnecting to our transmission systems. We are also pursuing development projects not within our existing systems, which likewise are 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 Note 3 to the condensed consolidated financial statements under “— Cost-Based Formula Rates with True-Up Mechanism.”

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

We derive nearly all of our revenues from providing electric transmission service over our Regulated Operating Subsidiaries' transmission systems to investor-owned utilities such as DTE Electric, 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 six months ended June 30, 2014 or may affect future results include:

• Our capital investment of \$430.1 million at our Regulated Operating Subsidiaries for the six months ended June 30, 2014, resulting primarily from our focus on improving system reliability, increasing system capacity and upgrading

the transmission network to support new generating resources;



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Debt issuances as described in Note 5 to the condensed consolidated financial statements and borrowings under our revolving and term loan credit agreements in 2014 and 2013 to fund capital investment at our Regulated Operating Subsidiaries and for general corporate purposes, resulting in higher interest expense;

Loss on extinguishment of debt of \$29.1 million related to the tender of \$115.6 million of the 5.875% ITC Holdings Senior Notes and \$54.7 million of the 6.375% ITC Holdings Senior Notes as described in Note 5 to the condensed consolidated financial statements;

Debt maturing within one year of \$250.0 million as of June 30, 2014 and the interest rates associated with the additional financing required;

The rate of return on equity (“ROE”) and capital structure complaint filed against all MISO Transmission Owners (“TOs”) including our MISO Regulated Operating Subsidiaries as described in Note 11 to the condensed consolidated financial statements; and

The accelerated share repurchase program (“ASR program”) entered in June 2014 for up to \$150.0 million which is part of the Board of Directors authorized share repurchase program of up to \$250.0 million authorized in April 2014 and expiring in December 2015 as described in Note 6 to the condensed consolidated financial statements.

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

Capital Project Updates and Other Recent Developments

ITC Great Plains

Kansas V-Plan Project

The Kansas V-Plan Project is a 200-mile long transmission line that will run between Spearville and Wichita, Kansas. ITC Great Plains is responsible for constructing an approximately 120-mile portion of the project from Spearville to Medicine Lodge, Kansas. ITC Great Plains commenced construction during 2012, and through June 30, 2014, ITC Great Plains has invested \$274.6 million in the Kansas V-Plan Project. We estimate that ITC Great Plains will invest a total of approximately \$300 million in its portion of the project, which is currently anticipated to be completed by the end of 2014.

Regulatory Assets

As of June 30, 2014, we have recorded a total of \$14.0 million of regulatory assets for start-up, development and pre-construction expenses, including associated carrying charges, incurred by ITC Great Plains, which include certain costs incurred for the Kansas Electric Transmission Authority (“KETA”) and the Kansas V-Plan Projects prior to construction. Based on ITC Great Plains’ FERC application under which authority to recognize these regulatory assets was sought and the related FERC order granting such authority, ITC Great Plains made a filing with the FERC under Section 205 of the FPA in May 2013 to recover these start-up, development and pre-construction expenses, including associated carrying charges, in future rates as discussed in Note 3 of the condensed consolidated financial statements.

Development Bonuses

We recognized general and administrative expenses of \$0.7 million and \$2.2 million during the three and six months ended June 30, 2014, respectively, and \$0.7 million and \$2.1 million during the three and six months ended June 30, 2013, respectively, for bonuses for certain development projects, including the successful completion of certain milestones relating to projects at ITC Great Plains. It is reasonably possible that future development-related bonuses may be authorized and awarded for these or other development projects.

Multi-Value Projects

2011 MISO Multi-Value Projects

In 2011, MISO implemented its Multi-Value Project (“MVP”) cost allocation methodology. In December 2011, MISO approved a portfolio of MVPs which includes portions of four MVPs that we will construct, own and operate. The four MVPs are located in south central Minnesota, northern and southeast Iowa, southwest Wisconsin, and northeast Missouri and will be constructed by ITC Midwest. We currently estimate we will invest approximately \$800 million in our portions of the MVPs from 2014 through 2018.



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Thumb Loop Project

The Thumb Loop Project, an additional MVP, is located in ITCTransmission's region and consists of a 140-mile, double-circuit 345 kV transmission line and related substations that will serve as the backbone of the transmission system needed to accommodate future wind development projects in the Michigan counties of Tuscola, Huron, Sanilac and St. Clair. In September 2013, Phase 1 of the Thumb Loop project, consisting of approximately 62 miles, was placed into service. Phase 2, consisting of approximately 20 miles, was placed into service in May 2014. Through June 30, 2014, ITCTransmission has invested \$410.2 million in the Thumb Loop Project. We estimate ITCTransmission will invest a total of approximately \$510 million in the project, which is currently anticipated to be completed in 2015.

Rate of Return on Equity and Capital Structure Complaint

In November 2013, certain parties filed a joint complaint with the FERC under Section 206 of the FPA, requesting that the FERC find the regional base rate of return on equity for all MISO TOs, including ITCTransmission, METC and ITC Midwest to be unjust and unreasonable. The joint complainants are seeking a FERC order reducing the regional base ROE rate used in our formula transmission rate from 12.38% to 9.15%, reducing the equity component of our capital structure from the FERC approved 60% to 50% and terminating the ROE adders currently approved for certain ITC operating companies, including adders currently utilized by ITCTransmission and METC. In the event a refund is required upon resolution of the complaint, the joint complainants are seeking a refund effective date as of November 12, 2013.

We believe that the ROE along with the ROE adders and approved capital structure encourage transmission investment and offset the burdens associated with maintaining the independent transmission business model and RTO membership. ITCTransmission, METC and ITC Midwest filed responses during the first quarter of 2014, separately and together with other MISO TOs, that seek dismissal of the complaint for its failure to satisfy the requirements of FPA Section 206 and the FERC's accompanying Rules, or denial of the complaint on the merits, with prejudice. It is reasonably possible that the refund exposure for a potential reduction to the ROEs of our MISO Regulated Operating Subsidiaries could result in a material impact on our results of operations, cash flows, and financial condition. The range of potential impact of this matter is not estimable due to the uncertainty of the calculation of an authorized ROE along with the zone of reasonableness, which is directly affected by the newly adopted two-step discounted cash flow methodology. The ROE to be established would be dependent on the appropriate proxy group and assumptions for short and long-term growth rates at the time the ROE is ultimately determined. There is additional uncertainty as to the effective date of any potential refund period. As of June 30, 2014, our MISO Regulated Operating Subsidiaries had a total of approximately \$2.5 billion of equity in their capital structures for ratemaking purposes. Based on this level of aggregate equity, we estimate that each 10 basis point reduction in the authorized ROE would reduce annual consolidated net income by approximately \$2.5 million. We continue to believe the likelihood of an unfavorable outcome of the complaint as it relates to the request to modify our existing capital structures is remote. See further discussion in Note 11 to the condensed consolidated financial statements.

Stock Split

On February 6, 2014, our board of directors declared a three-for-one split of our common stock to be accomplished by means of a stock distribution. The additional shares were distributed on February 28, 2014, to the shareholders of record on February 18, 2014. See further discussion in Note 6 to the condensed consolidated financial statements.

Accelerated Share Repurchase Program

On June 19, 2014, ITC Holdings entered into an accelerated share repurchase agreement of up to \$150.0 million (minimum of \$130.0 million) with JP Morgan Chase ("JP Morgan"), which is part of the Board of Directors authorized share repurchase program for up to \$250.0 million approved in April 2014 and expiring in December 2015. Under the ASR program, ITC Holdings paid \$150.0 million to JP Morgan and received an initial delivery of 2.9 million shares with a fair market value of \$104.0 million based on the closing market price of \$35.80 per share at the commencement of the ASR program. The final number of shares delivered under the ASR program will be based on the volume-weighted average share price of our common stock during the term of the transaction. The ASR program is expected to be completed by the end of 2014.

See further discussion in Note 6 and Note 8 to the condensed consolidated financial statements.

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

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investments in property, plant and equipment on a current rather than a lagging basis. The formula rate templates utilize forecasted expenses, property, plant and equipment, point-to-point revenues, network load at our MISO Regulated Operating Subsidiaries and other items for the upcoming calendar year to establish projected revenue requirements for each of our Regulated Operating Subsidiaries that are used as the basis for billing for service on their systems from January 1 to December 31 of that year. Our cost-based formula rate templates include a true-up mechanism, whereby our Regulated Operating Subsidiaries compare their actual revenue requirements to their billed revenues for each year to determine any over- or under-collection of revenue. The over- or under-collection typically results from differences between the projected revenue requirement used as the basis for billing and actual revenue requirement at each of our Regulated Operating Subsidiaries, or from differences between actual and projected monthly peak loads at our MISO Regulated Operating Subsidiaries. In the event billed revenues in a given year are more or less than actual revenue requirements, which are calculated primarily using information from that year's FERC Form No. 1, our Regulated Operating Subsidiaries will refund or collect additional revenues, with interest, within a two-year period such that customers pay only the amounts that correspond to actual revenue requirements for that given period. This annual true-up ensures that our Regulated Operating Subsidiaries recover their allowed costs and earn their allowed returns.

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

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

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

## Monthly Peak Load (in MW) (a)

	2014			2013			2012		
	ITC Transmission	METC	ITC Midwest	ITC Transmission	METC	ITC Midwest	ITC Transmission	METC	ITC Midwest
January	7,730	6,310	2,998	7,593	6,215	2,801	7,264	6,145	2,789
February	7,367	6,230	2,822	7,141	5,846	2,693	6,919	5,754	2,592
March	7,221	6,067	2,763	6,817	5,552	2,587	6,941	5,708	2,443
April	6,439	5,528	2,410	6,566	5,321	2,451	6,403	5,259	2,296
May	8,200	6,131	2,828	8,956	6,490	2,646	8,947	6,459	2,700
June	10,069	7,463	3,015	10,335	7,643	3,099	11,652	8,738	3,388
July				11,694	8,987	3,573	12,180	9,354	3,636
August				10,158	7,809	3,509	11,081	8,508	3,445
September				11,046	8,171	3,447	9,094	7,349	3,443
October				7,562	5,485	2,675	6,566	5,429	2,539
November				7,017	5,947	2,702	7,022	5,829	2,631
December				7,651	6,206	2,920	7,230	5,928	2,645
Total	47,026	37,729	16,836	102,536	79,672	35,103	101,299	80,460	34,547

(a)

Our MISO Regulated Operating Subsidiaries are each part of a joint rate zone. The load data presented is for all TOs 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.

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## Capital Investment and Operating Results Trends

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

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

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

(in millions)	Long-term Capital Investment Program 2014-2018	Actual Capital Investment for the six months ended June 30, 2014 (a)	Forecasted Capital Investment for the year ending December 31, 2014
Source of Investment			
ITCTransmission (b)	\$647	\$140.8	\$250 — 285
METC	546	73.9	130 — 150
ITC Midwest (c)	1,991	119.6	255 — 290
ITC Great Plains	194	95.8	95 — 115
Development	1,122	—	—
Total	\$4,500	\$430.1	\$730 — 840

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

(b) ITCTransmission's investment program includes the Thumb Loop Project that is under construction.

(c) ITC Midwest's investment program includes the 2011 MISO MVPs as discussed above under "Capital Project Updates and Other Recent Developments".

Investments in property, plant and equipment could vary due to, among other things, the impact of actual loads, forecasted loads, regional economic conditions, weather conditions, union strikes, labor shortages, material and equipment prices and availability, our ability to obtain any necessary financing for such expenditures, limitations on the amount of construction that can be undertaken on our systems at any one time, regulatory approvals for reasons

relating to rate construct, environmental, siting, regional planning, cost recovery or other issues and variances between estimated and actual costs of construction contracts awarded. In addition, investments in transmission network upgrades for generator interconnection projects could change from prior estimates significantly due to changes in the MISO queue for generation projects, the generator's potential failure to meet the various criteria of Attachment FF of the MISO tariff for the project to qualify as a refundable network upgrade, and other factors beyond our control.



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## RESULTS OF OPERATIONS

## Results of Operations and Variances

(in thousands)	Three months ended		Increase (decrease)	Percentage increase (decrease)	Six months ended		Increase (decrease)	Percentage increase (decrease)
	June 30, 2014	2013			June 30, 2014	2013		
OPERATING REVENUES	\$263,214	\$229,817	\$33,397	14.5 %	\$521,817	\$447,121	\$74,696	16.7 %
OPERATING EXPENSES								
Operation and maintenance	25,836	29,668	(3,832 )	(12.9 )%	50,697	54,181	(3,484 )	(6.4 )%
General and administrative	30,308	43,939	(13,631 )	(31.0 )%	58,270	78,865	(20,595 )	(26.1 )%
Depreciation and amortization	31,295	29,295	2,000	6.8 %	62,673	57,781	4,892	8.5 %
Taxes other than income taxes	17,076	16,094	982	6.1 %	38,269	32,764	5,505	16.8 %
Other operating (income) and expenses — net	(229 )	(173 )	(56 )	32.4 %	(461 )	(345 )	(116 )	33.6 %
Total operating expenses	104,286	118,823	(14,537 )	(12.2 )%	209,448	223,246	(13,798 )	(6.2 )%
OPERATING INCOME	158,928	110,994	47,934	43.2 %	312,369	223,875	88,494	39.5 %
OTHER EXPENSES (INCOME)								
Interest expense	45,854	40,402	5,452	13.5 %	91,163	79,465	11,698	14.7 %
Allowance for equity funds used during construction	(4,932 )	(8,292 )	3,360	(40.5 )%	(9,944 )	(17,025 )	7,081	(41.6 )%
Loss on extinguishment of debt	29,074	—	29,074	n/a	29,074	—	29,074	n/a
Other income	(236 )	(286 )	50	(17.5 )%	(397 )	(495 )	98	(19.8 )%
Other expense	1,625	2,671	(1,046 )	(39.2 )%	2,958	3,681	(723 )	(19.6 )%
Total other expenses (income)	71,385	34,495	36,890	106.9 %	112,854	65,626	47,228	72.0 %
INCOME BEFORE INCOME TAXES	87,543	76,499	11,044	14.4 %	199,515	158,249	41,266	26.1 %
INCOME TAX PROVISION	33,207	29,104	4,103	14.1 %	76,043	60,664	15,379	25.4 %
NET INCOME	\$54,336	\$47,395	\$6,941	14.6 %	\$123,472	\$97,585	\$25,887	26.5 %

## Operating Revenues

Three months ended June 30, 2014 compared to three months ended June 30, 2013

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

(in thousands)	2014		2013		Increase (decrease)	Percentage increase (decrease)
	Amount	Percentage	Amount	Percentage		

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Network revenues	\$186,300	70.8	%	\$177,880	77.4	%	\$8,420	4.7	%
Regional cost sharing revenues	63,934	24.3	%	40,325	17.5	%	23,609	58.5	%
Point-to-point	3,952	1.5	%	4,055	1.8	%	(103)	(2.5)	%
Scheduling, control and dispatch	3,231	1.2	%	3,133	1.4	%	98	3.1	%
Other	5,797	2.2	%	4,424	1.9	%	1,373	31.0	%
Total	\$263,214	100.0	%	\$229,817	100.0	%	\$33,397	14.5	%

Network revenues increased due primarily to higher net revenue requirements at our Regulated Operating Subsidiaries during the three months ended June 30, 2014 as compared to the same period in 2013. Higher net revenue requirements were due primarily to higher rate bases associated with higher balances of property, plant and equipment in-service.

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

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Six months ended June 30, 2014 compared to six months ended June 30, 2013

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

(in thousands)	2014		2013		Increase (decrease)	Percentage increase (decrease)	
	Amount	Percentage	Amount	Percentage			
Network revenues	\$375,076	71.9	% \$349,165	78.1	% \$25,911	7.4	%
Regional cost sharing revenues	123,253	23.6	% 77,794	17.4	% 45,459	58.4	%
Point-to-point	9,637	1.8	% 8,424	1.9	% 1,213	14.4	%
Scheduling, control and dispatch	6,393	1.2	% 6,122	1.4	% 271	4.4	%
Other	7,458	1.5	% 5,616	1.2	% 1,842	32.8	%
Total	\$521,817	100.0	% \$447,121	100.0	% \$74,696	16.7	%

Network revenues increased due primarily to higher net revenue requirements at our Regulated Operating Subsidiaries during the six months ended June 30, 2014 as compared to the same period in 2013. Higher net revenue requirements were due primarily to higher rate bases associated with higher balances of property, plant and equipment in-service. Regional cost sharing revenues increased due primarily to additional capital projects that have been identified by MISO as eligible for regional cost sharing and these projects being placed in-service.

Operating revenues for the six months ended June 30, 2014 include the network, regional cost sharing and scheduling, control and dispatch revenue accruals and deferrals as calculated below:

Line	Item (in thousands)	ITC Transmission	METC	ITC		Total net revenue deferral
				Midwest	Great Plains	
1	Estimated net revenue requirement (network revenues recognized) (a)	\$ 119,079	\$99,978	\$153,240	\$2,779	
2	Network revenues billed (b)	118,391	103,879	149,958	2,959	
3	Network revenue accruals (deferrals) (line 1 — line 2)	688	(3,901 )	3,282	(180 )	
4	Regional cost sharing revenue accruals (deferrals) (c)	1,750	(4,134 )	(125 )	(2,602 )	
5	Scheduling, control and dispatch revenue accruals (deferrals) (c)	229	(7 )	(348 )	—	
6	Total net revenue accrual (deferral) (line 3 + line 4)	\$ 2,667	\$(8,042 )	\$2,809	\$(2,782 )	\$(5,348 )

The calculation of net revenue requirement for our Regulated Operating Subsidiaries is described in our Form 10-K for the year ended December 31, 2013 under “Item 7 Management’s Discussion and Analysis of Financial Condition (a) and Results of Operations — Cost-Based Formula Rates with True-Up Mechanism — Revenue Requirement Calculation.” The amount is estimated for each reporting period until such time as FERC Form No. 1’s are completed for our Regulated Operating Subsidiaries.

(b) Network revenues billed at our MISO Regulated Operating Subsidiaries are calculated based on the joint zone monthly network peak load multiplied by their effective monthly network rates for 2014 of \$2.305 per kW/month, \$2.781 per kW/month and \$8.795 per kW/month applicable to ITC Transmission, METC and ITC Midwest, respectively, adjusted for the actual number of days in the month less amounts recovered or refunded associated with our MISO Regulated Operating Subsidiaries 2012 true-up adjustments. The rates for 2014 include amounts for the collection and refund of the 2012 revenue accruals and deferrals and related accrued interest as well as the FERC audit refund and related interest, as discussed in Note 11 to the condensed consolidated financial statements under “FERC Audit Refund.” The revenues billed in 2014 associated with the 2012 revenue accruals, deferrals and the amounts associated with the FERC audit refund are not included in the revenues billed. Our rates at ITC Great

Plains are billed ratably each month based on its annual projected net revenue requirement of \$58.1 million for 2014 and include amounts for the collection and refund of the 2012 revenue accruals and deferrals and related accrued interest.

These revenues are subject to a separate true-up mechanism whereby our Regulated Operating Subsidiaries accrue (c) or defer revenues for any over- or under-recovery. The revenue accruals and deferrals and related accrued interest are included in these revenue amounts.

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Operating Expenses

Operation and maintenance expenses

Three and six months ended June 30, 2014 compared to three and six months ended June 30, 2013

Operation and maintenance expenses decreased primarily due to lower vegetation management requirements and a decrease in substation maintenance activities.

General and administrative expenses

Three months ended June 30, 2014 compared to three months ended June 30, 2013

General and administrative expenses decreased \$18.7 million due to legal, advisory and financial services fees incurred in the prior period relating to the terminated Entergy Transaction. The decrease was partially offset by higher professional services such as legal, advisory and financial services fees of \$2.8 million unrelated to the Entergy Transaction in addition to \$1.1 million of higher compensation expenses primarily due to personnel additions.

Six months ended June 30, 2014 compared to six months ended June 30, 2013

General and administrative expenses decreased \$27.4 million due to legal, advisory and financial services fees incurred in the prior period relating to the terminated Entergy Transaction. The decrease was partially offset by higher professional services such as legal, advisory and financial services fees of \$3.7 million unrelated to the Entergy Transaction in addition to \$1.9 million of higher compensation expenses primarily due to personnel additions.

Depreciation and amortization expenses

Three and six months ended June 30, 2014 compared to three and six months ended June 30, 2013

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

Taxes other than income taxes

Three and six months ended June 30, 2014 compared to three and six months ended June 30, 2013

Taxes other than income taxes increased due to higher property tax expenses due primarily to our Regulated Operating Subsidiaries' 2013 capital additions, which are included in the assessments for 2014 personal property taxes.

Other Expenses (Income)

Three and six months ended June 30, 2014 compared to three and six months ended June 30, 2013

Interest Expense

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

Allowance for Equity Funds Used During Construction

Allowance for Equity Funds Used During Construction ("AFUDC equity") decreased due primarily to lower balances of construction work in progress during the period.

Loss on Extinguishment of Debt

The loss on extinguishment of debt related to the tender of \$115.6 million of the 5.875% ITC Holdings Senior Notes and \$54.7 million of the 6.375% ITC Holdings Senior Notes as described in Note 5 to the condensed consolidated financial statements.

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Income Tax Provision

Three months ended June 30, 2014 compared to three months ended June 30, 2013

Our effective tax rates for the three months ended June 30, 2014 and 2013 were 37.9% and 38.0%, respectively. Our effective tax rate in both periods exceeded our 35% statutory federal income tax rate due primarily to state income taxes, partially offset by the tax effects of AFUDC equity which reduced the effective tax rate. The amount of income tax expense relating to AFUDC equity was recognized as a regulatory asset and not included in the income tax provision. We recorded a state income tax provision of \$3.4 million (net of federal deductibility) during the three months ended June 30, 2014, compared to a state income tax provision of \$2.5 million (net of federal deductibility) for the three months ended June 30, 2013.

Six months ended June 30, 2014 compared to six months ended June 30, 2013

Our effective tax rates for the six months ended June 30, 2014 and 2013 were 38.1% and 38.3%, respectively. Our effective tax rate in both periods exceeded our 35% statutory federal income tax rate due primarily to state income taxes, partially offset by the tax effects of AFUDC equity which reduced the effective tax rate. The amount of income tax expense relating to AFUDC equity was recognized as a regulatory asset and not included in the income tax provision. We recorded a state income tax provision of \$7.9 million (net of federal deductibility) during the six months ended June 30, 2014, compared to a state income tax provision of \$5.4 million (net of federal deductibility) for the six months ended June 30, 2013.

In addition to the items noted above, our effective tax rate exceeded our 35% statutory federal income tax rate for the six months ended June 30, 2014 due to the previously assumed non-deductibility of certain costs incurred to facilitate the now canceled Entergy Transaction.

LIQUIDITY AND CAPITAL RESOURCES

We expect to fund our future capital requirements with cash from operations, our existing cash and cash equivalents and amounts available under our revolving credit agreements (described in Note 5 to the condensed consolidated financial statements). In addition, we may from time to time secure debt and equity funding in the capital markets, although we can provide no assurance that we will be able to obtain financing on favorable terms or at all. As market conditions warrant, we may also from time to time repurchase debt or equity securities issued by us, in the open market, in privately negotiated transactions, by tender offer or otherwise. We expect that our capital requirements will arise principally from our need to:

• Fund capital expenditures at our Regulated Operating Subsidiaries. Our plans with regard to property, plant and equipment investments are described in detail above under “— Capital Investment and Operating Results Trends.”

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

• Fund working capital requirements.

• Fund our debt service requirements, including principal repayments and periodic interest payments. We expect our interest payments to increase each year as a result of additional debt we expect to incur to fund our capital expenditures and for general corporate purposes.

• Fund contributions to our retirement plans, as described in Note 9 to the condensed consolidated financial statements. We expect to make an estimated additional contribution of approximately \$5.0 million to these plans in 2014. 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.

• Fund our authorized share repurchase program as described in Note 6 to the condensed consolidated financial statements.

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

requirements.

We believe that we have sufficient capital resources to meet our currently anticipated short-term needs. We rely on both internal and external sources of liquidity to provide working capital and to fund capital investments. ITC Holdings' sources of cash are dividends and other payments received by us from our Regulated Operating Subsidiaries and any other subsidiaries

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we may have in addition to the proceeds raised from the sale of our debt and equity securities. Each of our Regulated Operating Subsidiaries, however, is legally distinct from ITC Holdings and has no obligation, contingent or otherwise, to make funds available to us. 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 5 to the condensed consolidated financial statements, we entered into new revolving credit agreements in March 2014 at ITC Holdings and its Regulated Operating Subsidiaries totaling \$1.0 billion, an increase of \$275.0 million from the prior revolving credit agreements. As of June 30, 2014, we had consolidated indebtedness under our revolving and term loan credit agreements of \$601.0 million, with unused capacity under the revolving credit agreements of \$710.0 million. See Note 5 to the condensed consolidated financial statements for a detailed discussion of these agreements. During the three months ended June 30, 2014, we completed financings as described below.

On May 28, 2014, ITC Holdings issued \$400.0 million aggregate principal amount of its 3.65% Senior Notes, due June 15, 2024. The proceeds from the issuance were used to repay the senior notes validly tendered in the tender offer described in Note 5 to the condensed consolidated financial statements and for general corporate purposes, primarily the repayment of borrowings under the ITC Holdings revolving credit agreement.

On June 10, 2014, ITCTransmission issued \$75.0 million of 4.27% First Mortgage Bonds, Series F, due June 10, 2044 and agreed to issue an additional \$25.0 million of First Mortgage Bonds, Series F on August 22, 2014. The proceeds from the June issuance were used for general corporate purposes, primarily the repayment of borrowings under the ITCTransmission revolving credit agreement. See Note 5 to the condensed consolidated financial statements for further discussion.

As of June 30, 2014, we had approximately \$250.0 million of debt maturing within one year, which may be refinanced with long-term debt. To address our long-term capital requirements, 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 Ratings Services (a)	Moody's Investor Service, Inc. (b)
ITC Holdings	Senior Unsecured Notes	BBB+	Baa2
ITCTransmission	First Mortgage Bonds	A	A1
METC	Senior Secured Notes	A	A1
ITC Midwest	First Mortgage Bonds	A	A1
ITC Great Plains	Unsecured Credit Facility	A-	Baa1

On December 6, 2013, Standard and Poor's Ratings Services upgraded the senior unsecured credit ratings of ITC (a)Holdings and ITC Great Plains and reaffirmed the secured credit ratings of ITCTransmission, METC and ITC Midwest. All of the ratings have a stable outlook.

On April 15, 2014, Moody's Investor Service, Inc. reaffirmed the credit ratings for ITC Holdings and the operating (b)subsidiaries. All of the ratings have a stable outlook with the exception of ITC Great Plains which was updated to a positive outlook on May 5, 2014.

**Covenants**

Our debt instruments include senior notes, secured notes, first mortgage bonds, unsecured revolving and term loan credit agreements containing numerous financial and operating covenants that place significant restrictions, which are



described in Note 5 to the condensed consolidated financial statements and in our Form 10-K for the fiscal year ended December 31, 2013. As of June 30, 2014, we were in compliance with all debt covenants. In the event of a downgrade in our credit ratings, none of the covenants would be directly impacted, although the borrowing costs under our revolving credit agreements would increase.

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### Cash Flows From Operating Activities

Net cash provided by operating activities was \$196.0 million and \$184.8 million for the six months ended June 30, 2014 and 2013, respectively. The increase in cash provided by operating activities was due primarily to an increase in cash received from operating revenues of \$77.2 million during the six months ended June 30, 2014 compared to the same period in 2013. The increase was partially offset by higher interest payments (net of interest capitalized) of \$27.6 million, an increase in payments for operating expenses of \$17.8 million and higher income taxes paid of \$13.8 million.

### Cash Flows From Investing Activities

Net cash used in investing activities was \$375.4 million and \$426.1 million for the six months ended June 30, 2014 and 2013, respectively. The decrease in cash used in investing activities was due primarily to the timing of payments for investments in property, plant and equipment during the six months ended June 30, 2014 compared to the same period in 2013.

### Cash Flows From Financing Activities

Net cash provided by financing activities was \$154.2 million and \$279.0 million for the six months ended June 30, 2014 and 2013, respectively. The decrease in cash provided by financing activities was due primarily to the payments of \$198.5 million to retire long-term debt at ITC Holdings, the net decrease of \$131.7 million in amounts outstanding under our revolving and term loan credit agreements and the payment of \$150.0 million for the accelerated share repurchase program during the six months ended June 30, 2014 compared to the same period in 2013. These decreases were partially offset by an increase in proceeds from long-term debt issuances of \$373.7 million. See Note 5 to the condensed consolidated financial statements for detail on the issuances and retirements of long-term debt.

## CONTRACTUAL OBLIGATIONS

Our contractual obligations are described in our Form 10-K for the year ended December 31, 2013. There have been no material changes to that information since December 31, 2013, other than the items listed below and described in Note 5 to the condensed consolidated financial statements:

- Amounts borrowed under our new unsecured, unguaranteed revolving credit agreements, which replaced the previous unsecured, unguaranteed revolving credit agreements;
- Additional amounts borrowed under the ITC Holdings unsecured, unguaranteed term loan credit agreement, which were primarily used to repay outstanding revolving credit borrowings;
- The \$50.0 million borrowed under the METC unsecured, unguaranteed term loan credit agreement entered into in January 2014, due February 2015, which was primarily used to repay outstanding revolving credit borrowings;
- The issuance of \$400.0 million aggregate principal amount of ITC Holdings 3.65% Senior Notes, due June 2024, in May 2014, which was primarily used for the cash tender offer (described in Note 5 to the condensed consolidated financial statements) and to repay outstanding revolving credit borrowings;
- The issuance of \$75.0 million aggregate principal amount of ITC Transmission 4.27% First Mortgage Bonds, Series F, due 2044, in June 2014, which was primarily used to repay outstanding revolving credit borrowings; and
- The \$115.6 million of the 5.875% ITC Holdings Senior Notes and \$54.7 million of the 6.375% ITC Holdings Senior Notes validly tendered on May 30, 2014 which were subsequently retired.

## CRITICAL ACCOUNTING POLICIES

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of these condensed consolidated financial statements requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. The application of these policies necessarily involves judgments regarding future events. These estimates and judgments, in and of themselves, could materially impact the condensed consolidated financial statements and disclosures based on varying assumptions, as future events rarely develop exactly as forecasted, and even the best estimates routinely require adjustment. The accounting policies discussed in “Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies” in our Form 10-K for the fiscal year ended December 31, 2013 are considered by management to be the most important to an understanding of the consolidated financial statements because of their significance to the portrayal of



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our financial condition and results of operations or because their application places the most significant demands on management's judgment and estimates about the effect of matters that are inherently uncertain. There have been no material changes to that information during the six months ended June 30, 2014.

**RECENT ACCOUNTING PRONOUNCEMENTS**

See Note 2 to the condensed consolidated financial statements.

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

**Fixed Rate Debt**

Based on the borrowing rates currently available for bank loans with similar terms and average maturities, the fair value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,709.7 million at June 30, 2014. The total book value of our consolidated long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, was \$3,404.5 million at June 30, 2014. We performed an analysis calculating the impact of changes in interest rates on the fair value of long-term debt and debt maturing within one year, excluding revolving and term loan credit agreements, at June 30, 2014. An increase in interest rates of 10% (from 5.0% to 5.5%, for example) at June 30, 2014 would decrease the fair value of debt by \$132.6 million, and a decrease in interest rates of 10% at June 30, 2014 would increase the fair value of debt by \$143.5 million at that date.

**Revolving and Term Loan Credit Agreements**

At June 30, 2014, we had a consolidated total of \$601.0 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 June 30, 2014 would increase or decrease the total interest expense by \$0.7 million, respectively, for an annual period on a constant borrowing level of \$601.0 million.

**Other**

As described in our Form 10-K for the fiscal year ended December 31, 2013, we are subject to commodity price risk from market price fluctuations, and to credit risk primarily with DTE Electric, Consumers Energy and IP&L, our primary customers. There have been no material changes in these risks during the six months ended June 30, 2014.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

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

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

**Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting during the three months ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



## PART II. OTHER INFORMATION

## ITEM 1A. RISK FACTORS

For information regarding risk factors affecting us, see “Item 1A Risk Factors” of our Form 10-K for the fiscal year ended December 31, 2013. There have been no material changes to the risk factors set forth therein.

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

The following table sets forth the repurchases of common stock for the quarter ended June 30, 2014:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (a)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (in millions) (a)
April 2014 (b)	18,520	\$36.75	—	\$250.0
May 2014 (b)	77,366	36.76	—	250.0
June 2014 (c)	2,908,164	35.80	2,905,028	146.0
Total	3,004,050	\$35.83	2,905,028	

(a) In April 2014, our board of directors authorized a share repurchase program for up to \$250.0 million of common stock, which expires in December 2015. Pursuant to such authorization, on June 20, 2014, ITC Holdings entered into an accelerated share repurchase agreement with JP Morgan (“ASR program”) of up to \$150.0 million (minimum of \$130.0 million), under which ITC Holdings was delivered a specified number of shares based on the closing market price of \$35.80 per share at the commencement of the ASR program. The final number of shares delivered under the ASR program will be based on the volume-weighted average share price of our common stock during the term of the transaction. On June 19, 2014 ITC Holdings paid \$150.0 million to JP Morgan and received an initial delivery of 2,905,028 shares with a fair market value of \$104.0 million.

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

(c) Shares acquired were delivered to us by employees as payment of tax withholding obligations due to us upon the vesting of restricted stock in addition to shares delivered under the ASR program in which ITC Holdings received an initial delivery of 2,905,028 shares. See Note 6 to the condensed consolidated financial statements for detailed discussion on the ASR program.

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ITEM 5. OTHER INFORMATION

On April 4, 2014 the Board of Directors approved an amendment to ITC Holdings' Employee Stock Purchase Plan ("ESPP"), adding 125,000 shares to the total shares available for issuance under the ESPP. Adoption of the amendment was contingent on approval from ITC Holdings shareholders. On May 21, 2014, the amendment was approved by ITC Holdings' shareholders. A copy of the ESPP, as amended, is attached to this Form 10-Q as an exhibit.

ITEM 6. EXHIBITS

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

Exhibit No. Description of Document

4.36	Fifth Supplemental Indenture, dated May 16, 2014, between ITC Holdings Corp. and The Bank of New York Mellon Trust Company, N.A. (f.k.a. The Bank of New York Trust Company, N.A., as successor to BNY Midwest Trust Company), as Trustee (filed with Registrant's Form 8-K on May 16, 2014).
4.37	ITC Holdings Corp. Employee Stock Purchase Plan, as amended May 21, 2014.
4.38	Second Supplemental Indenture, dated as of June 4, 2014 between ITC Holdings Corp. and Wells Fargo Bank, National Association, as trustee (filed with Registrant's Form 8-K on June 4, 2014).
4.39	Sixth Supplemental Indenture, dated as of May 23, 2014, between International Transmission Company and The Bank of New York Mellon Trust Company, N.A. (as successor to BNY Midwest Trust Company), as trustee (filed with Registrant's Form 8-K on June 10, 2014).
10.132	Amended and Restated Generator Interconnection Agreement entered into by and among Midcontinent Independent System Operator, Inc., Michigan Electric Transmission Company, LLC and Consumers Energy Company, effective May 2, 2014
10.133	Form of Notice and Amendment to Stock Option Agreement for Executive Officers under Amended and Restated 2003 Stock Purchase and Option Plan, as amended (May 2014)
10.134	Form of Notice and Amendment to Stock Option Agreement for Executive Officers under Second Amended and Restated 2006 LTIP (May 2014)
10.135	Form of Stock Option Agreement for Executive Officers under Second Amended and Restated 2006 LTIP (May 2014)
10.136	Form of Stock Award Agreement for Executive Officers under Second Amended and Restated 2006 LTIP (May 2014)

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  
- 32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
  
- 101.INS XBRL Instance Document
  
- 101.SCH XBRL Taxonomy Extension Schema
  
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase
  
- 101.DEF XBRL Taxonomy Extension Definition Database
  
- 101.LAB XBRL Taxonomy Extension Label Linkbase
  
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 6, 2014

ITC HOLDINGS CORP.

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

By: /s/ Rejji P. Hayes  
Rejji P. Hayes  
Vice President, Treasurer and Interim Chief Financial Officer  
(principal financial officer)