

121 FERC ¶ 61,229
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

ITC Holdings Corp.	Docket Nos. EC07-89-000
ITC Midwest LLC	EC07-89-001
Interstate Power and Light Company	ER07-887-000
Midwest Independent Transmission System Operator, Inc.	ER07-887-001

Midwest Municipal Transmission Group v. Interstate Power and Light Company and Midwest Independent Transmission System Operator, Inc.	Docket No. EL07-85-000
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ORDER AUTHORIZING DISPOSITION OF JURISDICTIONAL FACILITIES,
ACCEPTING PROPOSED RATES AND JURISDICTIONAL AGREEMENTS
SUBJECT TO CONDITIONS, AND DISMISSING COMPLAINT

(Issued December 3, 2007)

1. On May 11, 2007, as amended on June 5, 2007, ITC Holdings Corp. (ITC Holdings), ITC Midwest LLC (ITC Midwest), Interstate Power and Light Company (IPL) (collectively, Applicants), and the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) filed a joint application under sections 203¹ and 205² of the Federal Power Act (FPA) seeking Commission authorization for the disposition and acquisition of certain jurisdictional facilities and approval of the rates, terms, and conditions for the sale of certain services. Applicants request authorization under section 203 for IPL to sell to ITC Midwest all of IPL's jurisdictional transmission facilities and related jurisdictional contracts, agreements, books, and records (the Transaction). They also request that the Commission make determinations regarding necessary filings in connection with proposed public offerings of ITC Holdings' common stock. Finally, Applicants request Commission approval under section 205 of proposed rates ITC

¹ 16 U.S.C. § 824b (2000) *amended by* Energy Policy Act of 2005, Pub. L. No. 109-58, § 1289, 119 Stat. 594, 982-83 (2005) (EPAAct 2005).

² 16 U.S.C. § 824d (2000).

Midwest would charge as an independent transmission company and certain proposed agreements between ITC Midwest and IPL and between ITC Midwest and the Midwest ISO.

2. On July 31, 2007, Midwest Municipal Transmission Group (Midwest Muni Group)³ filed a complaint under section 206 of the FPA⁴ regarding the return on equity (ROE) component of the formula rate used in determining IPL's annual transmission revenue requirement under the rate formula in Attachment O of the Midwest ISO Open Access Transmission and Energy Markets Tariff (Midwest ISO Tariff). Midwest Muni Group requests that its complaint be consolidated with the section 203 and 205 dockets established by Applicants' filing. Midwest Muni Group also filed an Offer of Settlement that would resolve the complaint proceeding.

3. In this order, we grant Applicants' request to transfer the jurisdictional facilities in question, finding that, although the Transaction may lead to some increase in transmission rates, it is likely to result in significant benefits related to the ownership of the transmission facilities by an independent transmission-only entity. There are likely to be significant benefits to competition itself along with concomitant benefits to power rates. We also make the determinations Applicants request regarding filings to be made in connection with proposed additional public offerings of ITC Holdings common stock. Finally, we accept Applicants' proposed rates and the agreements, subject to certain conditions. We also dismiss Midwest Muni Group's complaint because the outcome here is consistent with the terms under which Midwest Muni Group offered to withdraw its complaint.

I. Background

A. Description of the Parties

1. ITC Holdings

4. ITC Holdings is a holding company whose material assets currently consist of all the common stock of International Transmission Company (International Transmission) and the sole membership interest in Michigan Electric Transmission Company, LLC (METC). Both International Transmission and METC are independent transmission companies engaged exclusively in the transmission of electric energy in interstate

³ Midwest Muni Group's members are Iowa Association of Municipal Utilities, Minnesota Municipal Utilities Association, and Central Minnesota Power Supply Agency.

⁴ 16 U.S.C. § 824e (2000).

commerce.⁵ They are members of the Midwest ISO and have turned functional control of their transmission assets over to the Midwest ISO. Another subsidiary of ITC Holdings, ITC Grid Development, invests in transmission infrastructure through a wholly-owned subsidiary, ITC Great Plains. Neither ITC Grid Development nor ITC Great Plains currently owns or operates any transmission facilities, and neither entity will own any facilities used for the generation or distribution of electric energy.

2. ITC Midwest

5. ITC Midwest is a wholly-owned subsidiary of ITC Holdings. ITC Midwest was formed to own and operate the transmission assets of IPL that are the subject of the Transaction. ITC Midwest will engage exclusively in the transmission of electric energy in interstate commerce. Its transmission facilities will be under the functional control of the Midwest ISO.

3. Interstate Power and Light Company

6. IPL is a wholly-owned public utility subsidiary company of Alliant Energy Corporation (Alliant Energy).⁶ IPL is engaged primarily in the generation, transmission, distribution, and sale of electric energy and the purchase, distribution, transportation, and sale of natural gas. It provides service to approximately 700,000 gas and electric customers in Iowa and southern Minnesota. IPL owns 6,791 miles of transmission lines and associated substations in Iowa, Illinois, and Minnesota.⁷ It is a transmission-owning member (TO) of the Midwest ISO, and its rates for transmission service are set under the formula rate in Attachment O of the Midwest ISO Tariff.

B. Application

7. Applicants state that under their Asset Sale Agreement (ASA), IPL will sell, and ITC Midwest will acquire, all of the jurisdictional transmission assets of IPL rated at

⁵ See *ITC Holdings Corp.*, 102 FERC ¶ 61,182 (*ITC Holdings*), *reh'g denied*, 104 FERC ¶ 61,033 (2003); *Trans-Elect, Inc.*, 98 FERC ¶ 61,142 (*Trans-Elect I*), *order on reh'g*, 98 FERC ¶ 61,368 (*Trans-Elect II*) (2002).

⁶ Alliant Energy also owns Wisconsin Power and Light Company, a public utility providing electric and gas service in Wisconsin.

⁷ IPL also currently owns a single, approximately 9.5-mile, 161 kV line in Missouri.

Voltages of 34.5 kV and above, associated real property interests, support facilities and assets, and all related contracts, agreements, books and records that memorialize arrangements involving the transmission assets.

8. ITC Midwest seeks approval under section 205 to join the Midwest ISO as a TO by executing the Midwest ISO TO Agreement⁸ and a proposed agreement between ITC Midwest and the Midwest ISO under Appendix I of the Midwest ISO TO Agreement (Appendix I Agreement). ITC Midwest also submits proposed transmission rates for ITC Midwest as an independent transmission company within the Midwest ISO, to become effective upon closing of the Transaction. The rates would be calculated under a rate formula based on the generic formula in Attachment O of the Midwest ISO Tariff, modified to use projected data inputs with a true-up mechanism. ITC Midwest seeks approval of a 13.88 percent ROE and an actual capital structure targeted to reflect 60 percent equity and 40 percent debt to calculate the overall rate of return in the formula.

9. Applicants also submit two additional agreements for filing under section 205 of the FPA: a Transition Services Agreement (Transition Agreement) and a Distribution-Transmission Interconnection Agreement (DT Interconnection Agreement). Under the Transition Agreement, IPL would provide corporate administration, construction, maintenance, engineering, and system operating services to ITC Midwest for a transition period of up to three years. The DT Interconnection Agreement provides the terms and conditions for the interconnection of the transmission facilities ITC Midwest will acquire with IPL's distribution facilities.

C. Complaint

10. In its complaint, Midwest Muni Group requests that the 12.38 percent ROE currently authorized for determining IPL's transmission revenue requirement under the transmission rate formula in Attachment O of the Midwest ISO Tariff be reduced to 9.36 percent, which it argues is the current cost of equity capital IPL has invested in its transmission facilities. In its Offer of Settlement, Midwest Muni Group offers to continue to pay rates that reflect a 12.38 percent ROE, as long as this 12.38 percent level does not become a platform for higher incentive-based returns to IPL or any successor in ownership of IPL's transmission facilities, including ITC Midwest, for five years. Instead, the 12.38 percent would become a ceiling that could be increased only on cost-based grounds.

⁸ The full name of this document is Agreement of the Transmission Facilities Owners to Organize the Midwest Independent Transmission System Operator, Inc., a Delaware Non-Stock Corporation.

II. Notice of Filing and Responsive Pleadings

11. Notice of Applicants' initial filing was published in the *Federal Register*, 72 Fed. Reg. 29,150 (2007), with comments, protests, or interventions due on or before June 1, 2007. Notice of Applicants' amendment to their filing was published in the *Federal Register*, 72 Fed. Reg. 33,994 (2007), with comments, protests or interventions due on or before June 20, 2007.

12. Timely motions to intervene were filed by American Transmission Company LLC; Integrys Energy Group, Inc. and its subsidiaries, Wisconsin Public Service Corporation, Upper Peninsula Power Company, and Integrys Energy Services, Inc.; Iowa Consumers Coalition;⁹ Jo-Carroll Energy, Inc.; MidAmerican Energy Company; Midwest Independent Transmission System Operator, Inc.; Midwest ISO Transmission Owners;¹⁰ Resale Power Group of Iowa;¹¹ and Xcel Energy Services Company.¹²

⁹ Iowa Consumers Coalition is made up of Archer Daniels Midland Company; Bemis Company, Inc.; Cargill, Incorporated; Equistar Chemicals, L.P.; PPG Industries, Inc.; and United States Gypsum Company.

¹⁰ Midwest ISO Transmission Owners consist of: Ameren Services Company, as agent for Union Electric Company, Central Illinois Public Service Company, Central Illinois Light Co., and Illinois Power Company; American Transmission Systems, Incorporated, a subsidiary of FirstEnergy Corp.; City of Columbia Water and Light Department (Columbia, Missouri); City Water, Light & Power (Springfield, Illinois); Duke Energy Shared Services for Duke Energy Ohio, Inc., Duke Energy Indiana, Inc., and Duke Energy Kentucky, Inc.; Hoosier Energy Rural Electric Cooperative, Inc.; Indiana Municipal Power Agency; Indianapolis Power & Light Company; Michigan Public Power Agency; Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.; Northern Indiana Public Service Company; Northwestern Wisconsin Electric Company; Otter Tail Power Company; Southern Illinois Power Cooperative; Southern Indiana Gas & Electric Company; Southern Minnesota Municipal Power Agency; Wabash Valley Power Association, Inc.; and Wolverine Power Supply Cooperative, Inc.

¹¹ The Resale Power Group of Iowa is made up of City of Afton; Amana Society Service Company; Anita Municipal Utilities; Burt Municipal Utilities; Coggon Municipal Light Plant; City of Danville; City of Dike; Dysart Municipal Utilities; Farmers Electric Cooperative, Frytown; Grand Junction Municipal Utilities; Long Grove Municipal Electric; Maquoketa Municipal Electric Utility; Mount Pleasant Municipal Utilities; New London Municipal Utility; Ogden Municipal Utilities; State Center Municipal Utilities; Story City Municipal Electric Utility; Strawberry Point Utilities; Tipton Municipal Utilities; Traer Municipal Utilities; Vinton Municipal Electric Utilities; City of West Liberty; and Whittemore Municipal Utilities.

Illinois Commerce Commission filed a timely notice of intervention. Timely motions to intervene and protest or comment were filed by Central Iowa Power Cooperative (CIPCO); Corn Belt Power Cooperative (Corn Belt); Dairyland Power Cooperative (Dairyland); Great River Energy (Great River); Iowa Office of Consumer Advocate (IA Consumer Advocate);¹³ Midwest Muni Group, Missouri River Energy Services, and Wisconsin Public Power Inc. (these three entities are referred to collectively as Municipal Coalition); and the Southern Minnesota Municipal Power Agency (Southern Minnesota). Comments were filed by General Motors Corporation, the International Brotherhood of Electrical Workers, and Thumb Electric Cooperative. Applicants then filed an answer, and Municipal Coalition filed a limited answer to that filing.

13. Notice of Midwest Muni Group's complaint was published in the *Federal Register*, 72 Fed. Reg. 44,838 (2007), with answers, interventions, and comments due on or before August 20, 2007. Midwest ISO filed a timely answer. IPL filed a timely motion to dismiss and answer. ITC Midwest filed a timely motion to intervene and dismiss. Midwest ISO TOs and Jo-Carroll Energy, Inc. filed timely motions to intervene and comments. Midwest Muni Group filed an answer to the motions to dismiss.

III. Discussion

A. Procedural Matters

14. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

15. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest and/or answer unless otherwise ordered by the decisional authority. We will accept Applicants' answer and Municipal Coalition's limited answer to that filing in the proceedings under sections 203 and 205, and Midwest Muni Group's answer in the complaint proceeding, because they have provided information that assisted us in our decision-making process.

¹² Xcel Energy Services Company's filing was made on behalf of Northern States Power Company, a Minnesota corporation, and Northern States Power Company, a Wisconsin corporation.

¹³ The IA Consumer Advocate also requested an extension of time to comment, which was denied.

B. Section 205 Analysis**1. Proposed Transmission Rates**

16. ITC Midwest proposes that its annual revenue requirement and rates for providing transmission service be calculated using a rate formula based on the generic transmission rate formula in Attachment O of the Midwest ISO Tariff, with modifications to use projected data inputs with a true-up mechanism and a 13.88 percent ROE. The weighted cost of capital would be derived based on ITC Midwest's actual capital structure, the equity component of which the company is targeting to be 60 percent.

a. Return on Equity

17. ITC Midwest states that its proposed 13.88 percent ROE is consistent with Commission precedent and also with sound financial analysis. It states that its proposed ROE is based on the 12.38 percent ROE currently approved for use by all Midwest ISO TOs,¹⁴ with a 100 basis point incentive for independent ownership and a 50 basis point incentive for regional transmission organization (RTO) membership. This is the ROE that is currently approved for use by International Transmission.¹⁵ ITC Midwest argues that the rate effects of the proposed ROE are comparable to those approved by the Commission in its orders authorizing International Transmission and METC as independent transmission companies. ITC Midwest also states that its proposal is consistent with Order Nos. 679 and 679-A,¹⁶ in which the Commission stated its commitment to provide incentives for the formation of independent transmission companies.

18. In support of its proposed ROE, ITC Midwest filed a financial analysis, including a discounted cash flow (DCF) analysis using the Commission's electric DCF methodology, applied to ITC Holdings alone rather than using a proxy group. ITC

¹⁴ Application at 41 (citing *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2002), *reh'g denied*, 102 FERC ¶ 61,143 (2003), *order on voluntary remand*, 106 FERC ¶ 61,302 (2004), *aff'd in part, Pub. Serv. Co. of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005), *order on remand*, 111 FERC ¶ 61,355 (2005) (collectively, *Midwest ISO ROE Decisions*)).

¹⁵ Application at 41 (citing *ITC Holdings*).

¹⁶ *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 71 Fed. Reg. 43,294 (July 31, 2006), FERC Stats. & Regs. ¶ 31,222, *order on reh'g*, Order No. 679-A, 72 Fed. Reg. 1,152 (Jan. 10, 2007), FERC Stats. & Regs. ¶ 31,236 (2007), *order on reh'g*, Order No. 679-B, 119 FERC ¶ 61,062 (2007).

Midwest's analysis results in a cost of equity ranging from a low of 11.35 percent to a high of 18.94 percent, with a midpoint of 15.14 percent and a median of 11.83 percent. ITC Midwest also provides an analysis of ITC Holdings using an asset pricing model known as the Fama-French Three-Factor Model. It results in an indicated cost of equity ranging from a low of 13.48 percent, a high of 14.71 percent, a midpoint of 14.10 percent, and a median of 13.67 percent.

19. ITC Midwest states that it performed the ROE analysis of ITC Holdings in isolation because it is the only publicly-traded independent transmission company in the United States and therefore is unique. Because of this, the usual approach of establishing a proxy group of comparable firms and using analytical results derived for that proxy group cannot be used because there are no comparable firms. It states that if ITC Midwest were simply another diversified electric utility that owned transmission assets along with other assets, it would be reasonable to set ITC Midwest's allowed ROE using an appropriate proxy group, and one would expect ITC Midwest to fall near the middle of the proxy group range in such an analysis.

20. ITC Midwest submits that its financial analysis reflects risks it will face that IPL does not face. First, ITC Midwest will be a stand-alone, independent transmission company, lacking the larger, more diversified rate base of a traditional, vertically integrated public utility company. Second, ITC Midwest will assume risks that IPL has been reluctant to assume. In particular, ITC Midwest will invest in economically beneficial transmission expansion, which IPL does not plan to do. Third, ITC Midwest will face the hurdles that confront new transmission projects, including siting delays, zoning regulations, land use requirements, and public opposition.

21. ITC Midwest urges the Commission to consider the substantial but non-quantifiable benefits expected because of its desire and ability to invest in the IPL transmission system. These benefits include increased reliability, the mitigation of market power in generation, improved access to transmission for the production of alternative biofuels, and improved access to transmission for wind generation. ITC Midwest states that the need for substantial new transmission in the area in question is precisely the type of challenge for which an independent transmission company is best suited. It states that these transmission assets serve an area rich in the feedstocks used for ethanol production. Plans to increase ethanol production there will require additional generation, new transmission lines, and associated upgrades. Costs of these investments may be difficult to recover if the projected load does not materialize or becomes economically unsustainable. In addition, ITC Midwest states that based on 2006 data, Iowa and Minnesota rank third and fourth, respectively, among all states in installed wind generating capacity, and substantial improvements to the transmission grid are needed to realize the potential of wind power.

22. ITC Midwest notes that the Commission has recognized the benefits that independent, for-profit transmission ownership can bring. It asserts that International

Transmission's record of investment to date has borne out the Commission's confidence. ITC Midwest maintains that the Commission can encourage increased investment in transmission by approving the policy-based incentives sought here.

i. Protests

23. Dairyland states that in Order No. 679-A, the Commission found that incentive ROEs are for new projects that present special risks or challenges, not for routine investments made in the ordinary course of expanding the system to provide safe and reliable transmission service or for existing transmission rate base.¹⁷ A 100 basis point ROE incentive for both existing and new transmission facilities is thus inconsistent with Order No. 679. Dairyland also questions the reasonableness of the 50 basis point incentive for RTO participation. ITC Midwest will not be joining the Midwest ISO intentionally and voluntarily. Instead, it will be purchasing IPL assets that are already under the functional control of the Midwest ISO. In addition, ITC Midwest is bound by the ASA to keep the facilities in the Midwest ISO for five years after the closing of the Transaction. Dairyland states that while Order No. 679 provides that ROE incentives may apply to utilities that joined RTOs or ISOs because of merger conditions or market-based rate requirements, ITC Midwest's voluntary contractual obligation to keep the facilities in the Midwest ISO for at least five years obviates the need for an ROE incentive in this case.¹⁸

24. Municipal Coalition notes that Order No. 679 clearly requires that ROEs, including those enjoyed by transcos, be kept within the zone of reasonableness, as developed through a traditional DCF analysis.¹⁹ It says that ITC Midwest has not demonstrated that a 13.88 percent ROE is within the zone of reasonableness. ITC Midwest's attempt to use ITC Holdings as the sole proxy for ITC Midwest is inconsistent with Commission policy requiring that an ROE for use in RTO rates be based in a proxy group made up of transmission owners with a direct link to the RTO where the applicant is located.²⁰ As discussed below, Midwest Coalition also argues that ITC Midwest's analysis of ITC Holdings is fatally flawed in at least five respects: (1) it is circular; (2) it is distorted by acquisition-related and other short-term financial disturbances; (3) it

¹⁷ Dairyland Protest at 14 (citing Order No. 679-A at P 23, 44, 61).

¹⁸ *Id.* at 16-17 (citing Order No. 679 at P 331, n.180).

¹⁹ Municipal Coalition Protest at 15 (citing Order No. 679 at P 206).

²⁰ *Id.* at 16 (citing *Commonwealth Edison Co.*, 119 FERC ¶ 61,238, at P 78-79 (2007) (*ComEd*); *Trans-Allegheny Interstate Line Co.*, 119 FERC ¶ 61,219, at P 40 (2007)).

reflects unsustainable growth from an outdated baseline; (4) it is further distorted by the parent company's much more leveraged capital structure; and (5) it is based on a company whose stock is held by remarkably few shareholders.

25. Municipal Coalition argues that ITC Midwest's analysis of ITC Holdings is circular because all of ITC Holdings' revenues come through Commission-regulated rates for monopoly service. A DCF analysis limited to ITC Holdings simply measures the level of profit that investors and investment analysts predict the Commission will continue to permit ITC Holdings' operating subsidiaries to recover. Municipal Coalition states that Order No. 679-A explicitly recognized this circularity problem, and to resolve it the Commission required that the DCF methodology be applied so that the cash flows reflected in that analysis would "not be significantly affected by an incentive return."²¹

26. Municipal Coalition also alleges that several major short-term financial disturbances distort ITC Midwest's DCF analysis of ITC Holdings, and the analysis therefore does not reflect a sustainable constant growth rate. In particular, disturbances associated with ITC Holdings' purchase of METC and the announcement of its intentions to purchase IPL's transmission assets during the six-month study period distort the 14.6 percent Institutional Brokers Estimate System (I/B/E/S) and 16.0 percent Zack's Investment Research (Zack's) earnings per share growth rates on which ITC Midwest relies. Municipal Coalition maintains that by far the single largest driver of analysts' expectations for increases in ITC Holdings' earnings per share was a major jump from 2006 to 2007 attributable to ITC Holdings' acquisition of METC in October 2006. ITC Holdings' earnings per share were depressed during the study period by the issuance of debt and new equity to finance the acquisition of METC. Municipal Coalition states that according to the April 13, 2007 Value Line report on ITC Holdings, earnings per share declined by 21.5 percent from 2005 to 2006, but that was before the increased annual earnings level associated with the acquisition. Standard & Poor's explains in a recent stock report on ITC Holdings that following a leap upwards due to the growth spurt associated with this acquisition, ITC's earnings per share growth will moderate to "about 8.1 percent."²² Municipal Coalition thus maintains that the estimates of rapid earnings per share growth that drive ITC Midwest's study above 13.88 percent appear to represent comparisons of the post-acquisition ITC Holdings to a pre-acquisition baseline.

27. Municipal Coalition next argues that ITC Midwest's analysis of ITC Holdings is distorted by short-term earnings growth due to recent changes in International Transmission and METC's rates. The rates of International Transmission and METC

²¹ *Id.* at 37 (citing Order No. 679-A at P 62).

²² *Id.* at 39 (citing Standard & Poor's Stock Report, ITC Holdings Corp. at 1 (June 9, 2007), attached as Attachment 7 to that pleading).

have risen from about \$1.075/kW-month and \$0.98/kW-month to approximately \$2.12/kW-month and \$1.70/kW-month, respectively, because of the recent phase-out of rate caps in their pricing zones in the lower peninsula of Michigan and the related end of deferral periods in which rate increases had been accrued as regulatory assets in lieu of current collection. ITC Holdings also contemporaneously changed the way these companies' rates are calculated from a lagging test-year basis to a projected test-year basis. Municipal Coalition states that the revenues received by International Transmission and METC have skyrocketed as a result, and ITC Holdings' earnings have soared. One cannot infer from this that ITC Holdings' earnings will continue to increase at that rate over the long term, as Standard & Poor's recognizes.

28. Municipal Coalition argues that a 14.6 percent or 16.0 percent growth rate would be unsustainable even if it were the expected five-year growth from the current, post-acquisition baseline. The resulting cost of equity therefore should be disregarded. Municipal Coalition notes that the Commission has recently found that a 13.3 percent growth rate is not sustainable over time and therefore does not meet threshold tests of economic logic.²³ The Commission accordingly ruled that a DCF-based ROE that assumed a constant growth rate of 13.3 percent or higher was not reliable. Municipal Coalition states that the same conclusion applies here, especially since Standard & Poor's does not expect ITC Holdings to sustain earnings growth above 8.1 percent even for the short term.

29. Municipal Coalition submits that a study based on ITC Holdings rather than a proxy group, assuming it is appropriate, should look to Standard & Poor's 8.1 percent growth projection rather than the unsustainable, acquisition-influenced 14.6 percent and 16.0 percent growth projections on which ITC Midwest relies. Combining that growth projection with the dividend yields calculated by ITC Midwest produces a cost of equity below 12.38 percent in every case.

30. Municipal Coalition asserts that to the extent ITC Midwest relies on the Fama-French methodology rather than a DCF analysis, it is engaging in a collateral attack on Order No. 679. In that order, the Commission rejected requests that it adopt additional methodologies, including Fama-French.²⁴ Municipal Coalition argues that the DCF approach demonstrates that the high end of the zone of reasonableness does not exceed the current 12.38 percent ROE.

²³ *Id.* at 42-44 (citing *ISO New England, Inc.*, 109 FERC ¶ 61,147, at P 205 (2004), *reh'g denied*, 110 FERC ¶ 61,111, at P 23, *reh'g denied*, 111 FERC ¶ 61,344 (2005) (*ISO New England*)).

²⁴ *Id.* at 47 (citing Order No. 679 at P 99, 102).

31. Finally, Municipal Coalition challenges ITC Midwest's claim that its business is riskier than that of traditional vertically-integrated utilities. Municipal Coalition says that this argument contradicts ITC Holdings' representations in its prospectus, is inconsistent with the views of Wall Street analysts on the risk of investment in transmission relative to investment in generation, and is inconsistent with Commission findings that transmission is not riskier than vertically-integrated operations. ITC Holdings asserts in its prospectus that its performance is more predictable than that of other regulated businesses, citing, among other things, its formula rate, minimal commodity and energy demand risk, and lack of competition. Municipal Coalition also cites a January 2007 Standard & Poor's research update finding that ITC Holdings has a low business risk profile²⁵ and a report by Fitch Ratings finding that, based on low operating risk and a supportive regulatory environment, investment in the transmission sector is relatively low in risk compared to similar investment in the generation sector.²⁶ Municipal Coalition notes that the Commission has similarly rejected arguments that transmission operations are more risky than vertically-integrated utility operations.²⁷

ii. Answer

32. ITC Midwest states that it accepts the 12.38 percent ROE for transmission owners in the Midwest ISO and does not propose to change that ROE. It seeks to add to that ROE two policy-based incentives that the Commission has previously awarded to similarly situated companies: a 50 basis point incentive for RTO participation and a 100 basis point incentive for independence. ITC Midwest also asserts that it has supplemented the basis for this ROE with ample evidence.

33. ITC Midwest states that the Commission "will award the 50 basis point incentive for RTO participation even for facilities that already are under the control of an RTO, in order to encourage continued participation in RTOs."²⁸ It adds that the 100 basis points should be granted because "the Commission's authority to provide policy-based rate

²⁵ *Id.* at 49-50 (citing Standard & Poor's, *Research Update: ITC Holdings and Units 'BBB' Rating Affirmed After Acquisition Announcement* (Jan. 19, 2007)).

²⁶ *Id.* at 50 (citing Fitch Ratings, *U. S. Power Transmission Projects: Less Candy?* (April 2, 2007)).

²⁷ *Id.* at 50-51 (citing *City of Vernon, California*, Opinion No. 479, 111 FERC ¶ 61,092 at P 101, *clarified*, 112 FERC ¶ 61,214 (2005), *reh'g denied*, 115 FERC ¶ 61,297 (2006); *Midwest ISO ROE Decisions*, 100 FERC ¶ 61,292 at P 12, 30-31).

²⁸ Applicants' Answer at 12 (citing *ISO New England, Inc.* 106 FERC ¶ 61,280 (2004); *ComEd*).

incentives to encourage transmission investment predated Order No. 679, and it is that authority that Applicants ask the Commission to exercise here.”²⁹ Moreover, “even in Order No. 679 the Commission clearly endorsed an incentive ROE for independent transmission companies that ‘both encourages Transco formation and is sufficient to attract investment after the Transco is formed’ in part because ‘Transcos are spending their additional return on capital spending....’”³⁰ ITC Midwest argues that because there is no serious allegation that it will not be an independent transmission company as defined in the Commission’s *Policy Statement Regarding Evaluation of Independent Ownership and Operation of Transmission*,³¹ it should be granted the 100 basis points incentive approved for other independent transmission companies.

34. ITC Midwest states that much of Municipal Coalition’s protest is devoted to attacks on its DCF analysis, insistence that a non-comparable proxy group of integrated utilities must be used instead, and complaints that the application does not meet the tests established by Order No. 679. It states that it is not seeking incentives under that order and maintains that Municipal Coalition’s arguments are beside the point. The real question is “whether the policy incentive previously approved for independent ownership of transmission, and for placing control of transmission facilities under the control of an RTO, should be granted to ITC Midwest.”³² ITC Midwest states that it should.

35. With respect to the critique of its DCF and other studies, ITC Midwest attaches rebuttal testimony by its expert witness, Dr. Jonathan A. Lesser, which it claims “demonstrates why [Municipal Coalition’s] analysis is either irrelevant or incorrect.”³³ Dr. Lesser states that ITC Holdings has been recognized as a unique financial entity and that if there are no reasonable comparable firms, the only alternative is to evaluate investor expectations concerning ITC Holdings itself. He quotes a report by A.G. Edwards finding that ITC Holdings, as the first publicly-traded independent transmission company, is unique and therefore not a perfect match for any of its electric power peer groups for comparison purposes.³⁴ While it included ITC Holdings in its Wires and

²⁹ *Id.* at 13.

³⁰ *Id.* (citing Order No. 679 at P 221, 226).

³¹ 111 FERC ¶ 61,473 (2005).

³² Applicants’ Answer at 6.

³³ *Id.* at 10.

³⁴ See Exhibit IT-5 at 1-7, A.G. Edwards, *Equity Research Development Report: ITC Holdings* (Jan. 21, 2007).

Pipes Group, A.G. Edwards acknowledges that material differences exist between ITC Holdings and the rest of that group. Dr. Lesser quotes a similar report by Credit Suisse stating that it is difficult to value ITC Holdings, largely because there is no good comparable group.³⁵ According to Dr. Lesser, if two Wall Street firms state that ITC Holdings is not comparable to any peer group of firms, then setting ITC Midwest's allowed ROE using a zone of reasonableness estimated for the Midwest ISO TO group would be unreasonable.

36. With respect to Standard & Poor's 2007-2008 earnings growth estimate of 8.1 percent, Dr. Lesser states that the Standard & Poor's report contains no long-term forecast of earnings growth. Standard & Poor's does indicate that it continues to view ITC Holdings as a higher growth utility company with earnings growing substantially faster than dividends. He states that Municipal Coalition ignores other information in the same report, specifically the fact that the report assigns ITC Holdings to the highest risk category because of its relatively small capitalization and lack of diversification.

37. With respect to the circularity involved in focusing solely on ITC Holdings, Dr. Lesser maintains that any DCF analysis performed on a firm whose revenues and earnings are set by regulators confronts this problem. He states that this can make sole reliance on DCF results problematic. If the Commission's existing 12.38 percent ROE for the Midwest ISO TOs was the only controlling factor for investors' earnings expectations, the range of reasonable ROEs using a DCF analysis for that proxy group would consist of only one value, but Dr. Lesser maintains it does not. He therefore suggests that there must be other factors and uncertainties beyond regulatory expectations of investors, which is why he performed an analysis using the Fama-French model.

iii. Municipal Coalition's Answer

38. Municipal Coalition objects to ITC Midwest's reliance on the A.G. Edwards report. It notes that A.G. Edwards also states that it considers ITC Holdings' risk profile to be lower than the Wires and Pipes Group given more favorable federal, rather than state, regulation and no exposure to competitive energy businesses. Municipal Coalition argues that this report demonstrates that looking to other Midwestern utilities as proxies would, if anything, overstate the required risk compensatory rate of return.

³⁵ See Exhibit IT-5 at 8-20, Credit Suisse, *ITC Holdings Corp: Company Update* (Jan. 22, 2007).

iv. **Commission Determination**

39. ITC Midwest has not demonstrated that its proposed 13.88 percent ROE is within the range of reasonableness. Accordingly, we will require it to use the 12.38 percent ROE that is applicable to all Midwest ISO TOs, including IPL.

40. In Order No. 679, the Commission established its policies under FPA section 219 on incentives for transmission infrastructure investment, including incentives for the formation of independent transmission companies such as ITC Midwest. These policies are pertinent to this case regardless of whether Applicants are invoking Order No. 679 and FPA section 219. The Commission will permit incentives only if they result in just and reasonable rates.³⁶ Even an incentive ROE must be within the zone of reasonableness. This is consistent with the incentive ROEs previously approved for International Transmission and METC, which were based on the existing 12.38 percent ROE applicable to all Midwest ISO TOs and were within the range of returns produced by the DCF analysis used to establish the 12.38 percent ROE.

41. ITC Midwest seeks to add a 150 basis point incentive to the existing 12.38 percent ROE approved for use by any Midwest ISO TO. It suggests that the Commission may approve its proposed 13.88 percent ROE as consistent with the ROE approved for International Transmission without requiring an updated DCF analysis. We disagree. International Transmission's 13.88 percent ROE was approved in February 2003, less than a year after the hearing and decisions establishing the 12.38 percent ROE applicable to the Midwest ISO TOs. The Commission was able to determine that the 13.88 percent ROE was just and reasonable based on the range of reasonableness in the record established in the Midwest ISO TOs' generic ROE proceeding. However, five years have passed since that record was established, and an updated financial analysis is required to evaluate whether an increase above the 12.38 percent ROE now applicable to the IPL transmission facilities is just and reasonable.

42. There are a number of difficulties with Applicants' analysis. ITC Midwest's DCF analysis of ITC Holdings as a proxy for ITC Midwest reflects 14.6 percent I/B/E/S and 16.9 percent Zack's earnings per share growth rates, which the Commission has found do not represent sustainable long-term growth rates. The forecast earnings per share underlying the DCF analysis of ITC Holdings are affected by short-term impacts due to mergers and increases in revenues upon the expiration of the rate freezes in Michigan and the switch from use of lagging test-period costs to projected test-period costs in formula rates. These contribute to five-year growth estimates that do not represent sustainable long-term constant growth. Those earnings per share growth rates exceed the 13.3 percent growth rate that we recently summarily rejected in *ISO New England*. The

³⁶ Order No. 679 at P 2, 93.

Commission found there that a 13.3 percent growth rate is unsustainable over time and therefore fails to meet threshold tests of economic logic. ITC Midwest's DCF analysis of ITC Holdings therefore must be rejected.

43. We also are not persuaded to adopt ITC Midwest's analysis using the Fama-French variant of the Capital Asset Pricing Model (CAPM). The Commission has found that the problems of estimating the betas on which the CAPM methodology relies make betas, in isolation, unreliable predictors of risk. They therefore make the CAPM methodology, alone, inappropriate for determining the ROE for an individual company.³⁷

44. ITC Midwest states that it performed its ROE analysis on ITC Holdings in isolation because, as the only publicly-traded independent transmission company, ITC Holdings is unique, and, therefore, the Commission's usual approach of using analytical results derived for a proxy group of comparable firms cannot be used because there are no comparable firms. For this reason, ITC Midwest argues, setting ITC Midwest's allowed ROE using a zone of reasonableness estimated for the Midwest ISO TO group, as Municipal Coalition suggests, would be unreasonable. We disagree that a just and reasonable ROE cannot be established based on analysis of a proxy group of other electric utilities of comparable risk to ITC Midwest. The Commission relied on a proxy group of transmission owning members of the Midwest ISO to establish the 12.38 percent ROE currently authorized for the members of that RTO. However, if ITC Midwest believes that the Midwest ISO TO proxy group does not face risks comparable to those faced by ITC Midwest, it may propose use of an alternative proxy group reflecting firms of comparable risk to ITC Midwest. We disagree with ITC Midwest's suggestion that, because ITC Holdings is the only publicly-traded independent transmission company, it is not possible to construct a proxy group of firms of comparable risk. There are a number of ways to screen companies based on overall risk and arrive at a proxy group of companies with risk comparable to the utility whose ROE is at issue, even if that utility has unique characteristics that affect its overall risk. For instance, corporate credit ratings

³⁷ See *Consumers Energy Company*, Opinion No. 429, 85 FERC ¶ 61,100 at 61,362 (1998), *order on reh'g*, Opinion No. 429-A, 89 FERC ¶ 61,138 (1999), *order on reh'g*, Opinion No. 429-B, 95 FERC ¶ 61,084 (2001); *Orange and Rockland Utilities, Inc.*, Opinion No. 314, 44 FERC ¶ 61,253, *order on reh'g*, Opinion No. 314-A, 45 FERC ¶ 61,252 (1988) (*Orange & Rockland*). The Commission has previously rejected a CAPM methodology in part, for developing the market risk premium using nearly 60 years of historical data because whatever historical relationships existed between debt and equity securities may no longer hold. See *Orange & Rockland Utilities, Inc.*, 40 FERC ¶ 63,053, at pp. 65,208-09 (1987), *aff'd*, Opinion No. 314 at 65,208. The market risk premium used by ITC Midwest's witness was developed using 80 years of historical data.

can be an overall measure of risk, since they reflect a company's credit strength based on fundamental financial risk indicators. ITC Holdings has a corporate credit rating of BBB. In addition, Standard & Poor's has a rating system designed to measure each company's business risk relative to an overall utility industry business risk profile. Standard & Poor's rates ITC Holdings' business risk profile at 2 on a scale of 1 to 10, with 1 being excellent and 10 being vulnerable. Our rejection of ITC Midwest's proposal to change the ROE applicable to the IPL transmission assets is without prejudice to ITC Midwest making a new section 205 filing seeking to change its ROE supported by a DCF analysis of a proxy group of companies with risks comparable to ITC Holdings.

45. ITC Midwest is directed to file revised tariff sheets reflecting use of a 12.38 percent ROE in its Attachment O formula rate within 30 days of the close of the Transaction. In that filing, ITC Midwest should also revise the effective date on the proposed tariff sheets if it is other than the proposed effective date of January 1, 2008.

b. Capital Structure

46. ITC Midwest proposes to use its actual capital structure to calculate the weighted cost of capital in its rate formula. It says that this will be 60 percent equity and 40 percent debt. In support, it argues that the Commission has approved use of an actual capital structure for International Transmission that targeted 60 percent equity and 40 percent debt.

i. Protests

47. Municipal Coalition argues that the proposed ratio of equity to debt is unusually high. It states that according to ITC Holdings' 2006 annual report, ITC Holdings has a capital structure of approximately 30 percent equity and 70 percent debt. It argues that by investing the proceeds of ITC Holdings' debt as equity in its subsidiaries, ITC Holdings doubles the dollar value of the higher ROE it seeks. Because most of ITC Holdings' consolidated debt is at the parent company level, financial analysts look to this consolidated debt. Municipal Coalition states that it is unclear whether ITC Midwest will even issue substantial debt of its own. It argues that if the Commission approves any above-cost ROE, that return should apply only to the 30 percent share of ITC Holdings' capital structure that genuinely represents outside investor equity. Municipal Coalition argues that at most, only a 50 percent equity ratio should apply.

ii. Answer

48. In response, ITC Midwest states that the proposed capital structure is consistent with Commission precedent and appropriate from a financial standpoint. It notes that it will seek approval to issue debt securities under FPA section 204. ITC Midwest states that it must earn an equity return sufficient to support its credit rating, regardless of whether the source of its equity capital is its parent company.

iii. Commission Determination

49. We will accept ITC Midwest's proposal to use its actual capital structure with a target equity ratio of 60 percent. Use of the transmission-owning operating company's actual capital structure is consistent with the generic Attachment O rate formula, and reflects the Commission's preference to use a utility's own capital structure if the utility issues its own debt without guarantees, has its own bond rating, and has a capital structure within the range of capital structures approved by the Commission.³⁸ Municipal Coalition has provided no basis for treating ITC Midwest differently than other Midwest ISO TOs. ITC Midwest will issue its own debt,³⁹ and we expect it to have its own bond rating, as do International Transmission and METC. Further, we disagree with Municipal Coalition that ITC Midwest's equity ratio is unusually high. ITC Midwest's target capital structure is within the range of the capital structures used in the Attachment O rate formula by other investor-owned Midwest ISO TOs.⁴⁰ It is also consistent with the Commission's approval, in *ITC Holdings*, of International Transmission's use of its actual capital structure, reflecting a 60 percent equity ratio, in its Attachment O rate formula.⁴¹ Thus, using ITC Midwest's actual capital structure will not produce unjust and unreasonable rates. Rather, using ITC Midwest's capital structure and its actual cost of long-term debt to calculate its weighted cost of capital will reflect its actual financing costs and provide a return sufficient to maintain its debt and corporate credit ratings.

c. Use of Projected Inputs and True-up Mechanism

50. Applicants state that ITC Midwest anticipates the need for significant new investment. They therefore seek approval for a forward-looking Attachment O formula

³⁸ See, e.g., *Transcontinental Gas Pipe Line Corp.*, Opinion No. 414-A, 84 FERC ¶ 61,084 at 61,413-415, *reh'g denied*, Opinion No. 414-B, 85 FERC ¶ 61,323 (1998), *petition for review denied*, *North Carolina Utilities Commission v. FERC*, D.C. Cir. Case No. 99-1037 (February 7, 2000) (per curiam).

³⁹ On September 18, 2007, in Docket No. ES07-63-000, ITC Midwest filed an application under section 204 seeking authorization to issue up to \$175 million in first mortgage bonds and up to \$75 million of debt through a revolving credit facility.

⁴⁰ The weighted costs of capital used to calculate the Attachment O revenue requirements of the 15 investor-owned Midwest ISO TOs currently reflect equity ratios that average 58 percent. Attachment O formula calculations for rates taking effect June 2007 are posted at http://www.midwestiso.org/publish/Document/4c0ece_1133f7bab9f_-7e900a48324a?rev=3.

⁴¹ *ITC Holdings*, 102 FERC ¶ 61,182 at P 68.

rate with a true-up mechanism. ITC Midwest would hold constant through 2008 the charges for transmission service applicable to IPL's transmission assets, effective June 1, 2007, as those charges were calculated under IPL's Attachment O. Starting January 1, 2008, these charges would become subject to true-up with interest in the year following the filing of ITC Midwest's FERC Form No. 1 with information as to its actual costs for 2008. Starting January 1, 2009, ITC Midwest's charges for transmission service would change each January 1 to reflect its estimated costs for the following calendar year, and these rates would similarly be subject to true-up with interest. That estimated revenue requirement for the following calendar year would be provided to customers and interested state commissions no later than September 1 of each year. ITC Midwest would hold a customer meeting by October 30 of each year to explain those formula rate input projections and cost details. ITC Midwest points out that the Commission has already accepted such a rate treatment for International Transmission and METC.⁴²

i. Protests

51. Municipal Coalition states that it is not clear that either IPL's Attachment O or ITC Midwest's proposed Attachment O will achieve the result explained in the application. It notes that IPL's Attachment O, which is the source of the charges that took effect on June 1, 2007 and which ITC Midwest proposes to continue until January 1, 2009, has no true-up mechanism. ITC Midwest's Attachment O is proposed to be effective January 1, 2008 and includes ITC's proposed 13.88 percent ROE (rather than IPL's 12.38 percent ROE), as well as a true-up mechanism. Municipal Coalition states that it is difficult to ascertain from ITC Midwest's filing either the rates it will apply when issuing initial bills for service rendered on and after January 1, 2008 or the level to which it will true up those charges. Municipal Coalition further argues if ITC Midwest's formula rate divides the current year's year-end revenue requirement by the current year's average monthly peak loads, it will lead to over-recovery of ITC Midwest's costs.

52. The IA Consumer Advocate states that IPL's transmission rates are set by the Iowa Utilities Board (Iowa Board) based on historical data that is subject to audit and investigation. It is concerned by ITC Midwest's proposal to set rates based on projected costs without further filing with the Commission. The IA Consumer Advocate questions whether ITC Midwest's rate-setting process would satisfy due process requirements under state and federal law and produce just and reasonable rates.

⁴² ITC Midwest cites to *Michigan Electric Transmission Company, LLC*, 117 FERC ¶ 61,314 (2006) and *International Transmission Co.*, 116 FERC ¶ 61,036 (2006).

53. Great River argues that the Commission should require ITC Midwest to clarify transmission customers' rights to obtain supporting details regarding the inputs, something the Commission required of METC.

ii. Answer

54. ITC Midwest states that it will make available to customers its projected net revenue requirement, load, and resulting rates incorporating the true-up adjustment, including all inputs, in sufficient detail to identify the components of its net revenue requirement and resulting rates. ITC Midwest will hold a customer meeting to explain the formula rate input projections and cost detail. It states that the Commission has approved this procedure in connection with ITC Holdings' existing subsidiaries, International Transmission and METC. ITC Midwest states that it will adopt the same tariff provisions approved by the Commission for METC regarding information sharing, as Great River requests.

55. In response to the IA Consumer Advocate's concern that there be a mechanism for audit and investigation of ITC Midwest's transmission rates, ITC Midwest states that any entity may file a complaint under section 206 of the FPA to challenge the justness and reasonableness of rates under its Attachment O formula rate.

iii. Commission Determination

56. We will conditionally accept ITC Midwest's proposal to use forward-looking estimated costs with a true-up mechanism. The Commission has accepted formula rates for public utilities for many years, if the formula is clear enough that all parties can determine what costs go into the rate and how it will be calculated.⁴³ The use of projected costs is consistent with the Attachment O formula rates that we have approved for International Transmission and METC. ITC Midwest states that it will conduct the same kinds of customer meetings to share information regarding the rate inputs as the Commission approved for International Transmission and METC. It also agrees to adopt the same tariff provisions approved by the Commission for METC regarding sharing information.⁴⁴ We will accept these commitments, as they will ensure that customers can monitor whether ITC Midwest is implementing the rate formula correctly.

⁴³ See *Midwest Independent Transmission System Operator, Inc.*, 101 FERC ¶ 61,221 at P 64 (2002), *order on reh'g*, 103 FERC ¶ 61,035 (2003), *order on paper hearing and compliance filing*, 108 FERC ¶ 61,235 at P 60-62, 68-75 (2004).

⁴⁴ *Michigan Electric Transmission Company, LLC*, 117 FERC ¶ 61,314 (2006) (December 21 Order), *order on reh'g*, 118 FERC ¶ 61,139 (February 21 Order), *order on compliance*, 119 FERC ¶ 61,203 (2007) (May 30 Order). In the December 21 Order, the
(continued...)

57. We disagree with Municipal Coalition's claim that ITC Midwest's proposal would mismatch the current year's year-end costs with average monthly peak load, resulting in over-recovery of costs. In fact, note U of ITC Midwest's proposed Attachment O formula indicates that the 13-month average balances would be used for inputs to rate base and capital structure. ITC Midwest thus will use average monthly costs and average monthly peak load, so there will be no mismatch to cause over-recovery of costs, as Municipal Coalition claims. However, we will direct ITC Midwest to clarify in its tariff sheets its proposal to continue through 2008 the charges for transmission service applicable to IPL's transmission assets effective June 1, 2007. Those charges were derived under IPL's Attachment O, and are subject to subsequent true up to ITC Midwest's actual costs for 2008. We order ITC Midwest to revise its tariff sheets, in the compliance filing to be made within 30 days of the close of the Transaction, to reflect such clarification and to include the information sharing provisions approved by the Commission for METC.

d. Accumulated Deferred Income Taxes

58. Section 7.6(b) of the ASA states:

Seller will elect to treat the transaction as a taxable asset sale. As a result of this election, Buyer will increase its basis in the assets for tax purposes, and Seller is recognizing a taxable gain on the assets. The tax basis and book basis are expected to be equal after the election is made, which would result in no recognition of deferred taxes on the Closing Date.

Commission accepted METC's commitments to provide the Michigan Public Service Commission (Michigan Commission) with all the projected revenue requirement information it provides to METC's customers and to invite the Michigan Commission to participate in the annual customer meeting at which METC explains the formula rate input projections and cost detail. The Commission also accepted METC's commitment to provide its customers and the Michigan Commission with complete information related to its ongoing and projected construction expenditures included in its projected revenue requirement. In the February 21 Order, the Commission clarified that information regarding projected costs of plant in forecasted rate base, expected construction schedule, and in-service dates is essential so that customers and the Michigan Commission can evaluate the accuracy of projected costs that form the basis of METC's rates. The Commission also clarified that it expected METC to provide, if requested, a description of the basis upon which the Midwest ISO or METC planned projects so that customers could evaluate the reasonableness of rates resulting from each annual update to METC's Attachment O formula. The Commission required METC to file revised tariff sheets to reflect these commitments.

i. Protests

59. Municipal Coalition argues that the balance of accumulated deferred income taxes (ADIT) associated with IPL's transmission assets should not be zeroed out when the assets are transferred to ITC Midwest. It argues that this balance should be carried forward on ITC Midwest's books instead and submits that, at very least, the rate effects of eliminating the ADIT balance should be considered as an incentive along with the proposed ROE incentive. IPL in the past paid less in taxes than it collected from ratepayers for tax coverage, and because actual taxes were reduced by accelerated depreciation, the Transaction would eliminate the ADIT rate base deduction that ratepayers have earned by pre-paying their share of IPL's income tax liability. Municipal Coalition views these payments as an advance to the company by ratepayers, not an investment by shareholders. It calculates that elimination of the ADIT balance would increase the annual transmission revenue requirement for the IPL transmission facilities by about \$12 million.

60. Municipal Coalition recognizes that the Commission allowed limited ADIT write-offs when International Transmission and METC were spun off. It also recognizes that the Commission allowed METC to eliminate a small amount of ADIT when METC was formed through a pre-settled transaction.⁴⁵ Municipal Coalition maintains that neither case controls here because ITC Midwest has not limited itself to avoiding taxation on the difference between regulatory and tax net book value, nor has it made the concessions that METC made to get customer and state regulator support.

ii. Answer

61. ITC Midwest argues that the proposed treatment of ADIT is correct as a matter of accounting. It points out that the transaction involves the sale and purchase of assets and explains that for these transactions, the Internal Revenue Service (IRS) requires that ADIT balances on the seller's books at the time of sale not be reflected on the purchaser's books following the sale. Inclusion of IPL's ADIT balances on ITC Midwest's books would violate tax normalization rules and result in ITC Midwest losing its ability to use accelerated depreciation for tax purposes.⁴⁶

⁴⁵ Municipal Coalition cites to *International Transmission Co.*, 92 FERC ¶ 61,276 (2000) and *Trans-Elect, Inc.*, 98 FERC ¶ 61,368, at 62,590-91 (2002).

⁴⁶ Applicants have included a legal memorandum from ITC Midwest's tax counsel that explains the matter in greater detail.

iii. Commission's Determination

62. This issue arises, in part, because IPL has taken advantage of accelerated depreciation for income tax purposes while rates have been set using straight line depreciation under income tax normalization rules. As a result, the tax basis of IPL's transmission assets is lower than the remaining cost of the plant on its books. IPL therefore faces a tax liability even if it sells transmission plant at book cost. Recognition of the gain on the sale by IPL in its taxable income in effect causes past deferred taxes to become due at the time of the sale as taxes on the portion of the gain due to accelerated depreciation, which is treated as ordinary income.

63. We find that IPL's existing ADIT balance associated with the assets subject to the Transaction should be reduced to zero as of the time of sale, rather than being carried forward to the books of ITC Midwest. To do otherwise would violate the IRS tax normalization rules and endanger ITC Midwest's right to use accelerated depreciation for tax purposes in the future. Although the Commission is not bound by IRS rules when determining ratemaking policy, we nonetheless take these tax considerations into account, and we are reluctant to endanger a utility's right to favorable tax treatment.⁴⁷ Moreover, this treatment removes any disincentive to divest transmission facilities to form independent transmission companies, and it is consistent with the treatment of ADIT when International Transmission and METC were formed as independent transmission companies.⁴⁸

⁴⁷ See, e.g., *Koch Gateway Pipeline Company*, 74 FERC ¶ 61,088, at 61,276, *reh'g denied in pertinent part*, 75 FERC ¶ 61,132 (1996).

⁴⁸ We note that the effect on rate base of zeroing out ADIT upon transfer of the assets in this case is not out of line with the corresponding effects when International Transmission and METC were spun off to independent owners. In the case of International Transmission, the company had an ADIT balance of approximately \$57 million prior to the asset transfer, 15 percent of net plant in service. METC had an ADIT balance of approximately \$43 million, or 20 percent of net plant in service, prior to the asset transfer. Here, the \$75 million ADIT balance associated with IPL's transmission assets is 19 percent of the net book value of those assets. We note that International Transmission and METC also received approval to recover through rates an acquisition premium equal to the balance of ADIT associated with the assets immediately prior to the transfer. See *ITC Holdings*, 102 FERC ¶ 61,182 at P 62; *Trans-Elect II*, 98 FERC ¶ 61,368 at 62,590-91. ITC Midwest is not requesting recovery of such an acquisition premium.

2. Related Contracts

a. Transition Services Agreement

64. The Transition Agreement specifies that IPL will provide to ITC Midwest the following transition services upon consummation of the Transaction and for one year thereafter: (1) corporate administration services; (2) construction and maintenance services, for which IPL will act as general contractor for ITC Midwest; (3) engineering services; and (4) system operating services. The Transition Agreement gives ITC Midwest the option to extend the contract for up to four additional six-month periods if that is reasonably necessary to continue the transition.

i. Protests

65. Municipal Coalition notes that section 1(f) of the Transition Agreement provides that IPL will supply a capital project schedule to ITC Midwest after closing and that ITC Midwest agrees to implement the capital projects set forth in the schedule. Municipal Coalition argues that no transmission customer other than IPL receives such treatment. It states that there has been no effort to discuss with other customers whether the projects in IPL's capital project schedule are the best way to solve problems on the IPL grid. ITC Midwest has not even committed to duplicate in Iowa the "Partners in Business" quarterly meeting process that it practices in Michigan, which at least provides regular updates on planning and construction and an opportunity for stakeholder dialogue with senior management. Municipal Coalition also points out that the provisions fail to mention any coordination with Midwest ISO regarding IPL's schedule of upgrades.

66. Municipal Coalition maintains that these concerns are not theoretical. IPL's current plans include projects designed to benefit IPL needs, without including the fixes needed to make the grid serve the needs of other customers. Municipal Coalition argues that further study could show the need for different solutions.

ii. Answer

67. ITC Midwest and IPL state that there is no pre-existing agreement between them regarding what projects will or will not be built. The Transition Agreement is rather a short-term agreement intended to permit completion of the Transaction without disrupting necessary transmission construction. The IPL-identified projects will be a base-line for what will be needed. ITC Midwest expects to find additional opportunities once it has studied the system. If circumstances change as studies are completed and better solutions are found to address matters currently identified by IPL planners, ITC Midwest may adjust its investments accordingly. In addition, ITC Midwest states that it will hold quarterly "partners in business" meetings that will provide additional

opportunities for dialogue and information exchange. Finally, ITC Midwest states that it will participate fully in the Midwest ISO regional planning process and will comply with any revised planning requirements adopted under Order No. 890.⁴⁹

iii. Commission Determination

68. We will conditionally accept the Transition Agreement, as discussed below. Section 1(f) of the Transition Agreement commits ITC Midwest to “use commercially reasonable efforts, to the extent consistent with good utility practice,” to execute the capital projects in IPL’s capital project schedule. It is reasonable for ITC Midwest to initially adopt IPL’s capital project schedule upon the close of the Transaction in order to ensure that no disruption in necessary transmission construction occurs during the transition to independent planning by ITC Midwest. However, a potential for undue discrimination exists if ITC Midwest is bound to construct any particular capital projects pre-determined by IPL outside the transmission system planning and interconnection process under the Midwest ISO Tariff. While ITC Midwest and IPL state that there is no pre-existing agreement between them regarding what projects will or will not be built, and that ITC Midwest will comply with any revised planning requirements adopted under Order No. 890, the language in section 1(f) of the Transition Agreement appears to bind ITC Midwest to complete IPL’s capital project schedule without any limitation, temporal or otherwise. To ensure that the Transition Agreement does not result in unduly discriminatory transmission access or transmission system planning, we will direct IPL and ITC Midwest to file, within 30 days of the close of the Transaction, a revised Transition Agreement removing any obligation on the part of ITC Midwest to complete IPL’s capital project schedule that is not necessary to avoid disruption in existing construction projects. That revised Transition Agreement should also reflect rate schedule designations in compliance with Order No. 614.⁵⁰

69. We will also condition acceptance of the Transition Agreement on ITC Midwest filing periodic status reports during the term of that agreement. Addressing a similar arrangement between Detroit Edison and International Transmission in *ITC Holdings*, the Commission recognized there were valid reasons for such an interim arrangement but found that it could not permit the agreement to continue for a protracted time period because of its obvious threat to International Transmission’s independence. Accordingly, the Commission limited the term of the agreement to one year, after which International

⁴⁹ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 Fed. Reg. 12,266 (Mar. 15, 2007), FERC Stats. & Regs. ¶ 31,241 (2007), *reh’g pending*.

⁵⁰ *Designation of Electric Rate Schedule Sheets*, Order No. 614, FERC Stats. & Regs. ¶ 31,096 (2000).

Transmission was required to self-provide such services or procure them from independent third parties.⁵¹ We expect ITC Midwest to use reasonable efforts to complete the transition as soon as possible. However, rather than limit ITC Midwest's flexibility to extend the Transition Agreement beyond the initial term if necessary to continue the transition from IPL to ITC Midwest, we will instead require ITC Midwest to file biannual informational status reports on its progress in making the transition to independence. The first such report is due 6 months after the Transaction closes, and subsequent reports are due in six-month intervals thereafter, until the Transition Agreement terminates.

b. Distribution-Transmission Interconnection Agreement

70. The DT Interconnection Agreement establishes the rights, responsibilities, and obligations of ITC Midwest and IPL relative to the interconnection of ITC Midwest's transmission facilities with IPL's distribution facilities.

i. Protests

71. Municipal Coalition argues that the DT Interconnection Agreement creates an undue preference in favor of IPL and grants IPL the sole right to enforce crucial public utility obligations. It notes that section 7.1 of this agreement imposes on ITC Midwest a duty to operate, maintain, plan, and construct its transmission system to meet the needs of all loads on the electric distribution systems connected to and dependent upon ITC Midwest's facilities in a non-discriminatory manner and not to assign charges directly unless approved by the appropriate regulatory body. Section 7.5 further commits ITC Midwest to plan and construct new interconnections to meet IPL's load growth and reliability needs and provides that the cost of such additions will be recovered in accordance with DT Interconnection Agreement section 7.1. Municipal Coalition is concerned that ITC Midwest's obligations under section 7.5 are covered by the rate provisions of DT Interconnection Agreement section 7.1, but they are apparently are not covered by the non-discrimination provisions of section 7.1.

72. Municipal Coalition also notes that DT Interconnection Agreement section 27.3 makes clear that "[n]othing in this Agreement, express or implied, is intended to confer on any person other than the Parties hereto any rights, interests, obligations or remedies hereunder." Municipal Coalition argues that while the non-discrimination provision in section 7.1 of the DT Interconnection Agreement limits the actions IPL can require under that agreement, no other transmission customer can contractually enforce the public utility obligations in question against ITC Midwest. Municipal Coalition states that these contractual provisions may invite difficult-to-detect undue preferences. In order to avoid

⁵¹ *ITC Holdings*, 102 FERC ¶ 61,182 at P 52-54.

creating an incentive and opportunity for such preferences, it requests that the Commission require that the DT Interconnection Agreement be revised to eliminate the provision on third-party beneficiaries so other customers can hold ITC Midwest accountable contractually in the same manner as IPL.

ii. Answer

73. ITC Midwest and IPL stress that the DT Interconnection Agreement is a distribution-to-transmission interconnection agreement that will govern their interconnection relationship following the sale of IPL's transmission assets to ITC Midwest. They argue that section 27.3 of the DT Interconnection Agreement is a standard contractual provision contained in other interconnection agreements. They also say that the non-discrimination mandate of the FPA will continue to apply and protect the interests of other parties.

iii. Commission Determination

74. We will accept the DT Interconnection Agreement without modification. We disagree with Municipal Coalition that the DT Interconnection Agreement will result in undue preference or discrimination. The rights of other ITC Midwest customers to rates, terms and conditions of service that are just and reasonable and not unduly discriminatory are inherent in sections 205 and 206 of the FPA and are protected by the Midwest ISO Tariff. Nothing in the DT Interconnection Agreement infringes on those rights. Municipal Coalition has not suggested how the DT Interconnection Agreement could invite difficult-to-detect undue preferences, and that claim is thus purely speculative. The DT Interconnection Agreement is an agreement between two parties, and there is no reason it should not include standard contract language stating that third parties do not have rights under the contract at issue. Other customers can pursue their rights under the FPA directly with ITC Midwest, the Midwest ISO, or the Commission.

75. We direct the Midwest ISO and ITC Midwest to file a revised DT Interconnection Agreement designated in compliance with Order No. 614, as a service agreement under the Midwest ISO Tariff,⁵² within 30 days of the close of the transaction.

c. Appendix I Agreement

76. Appendix I to the Midwest ISO TO Agreement sets forth the general framework for participation of independent transmission companies in the Midwest ISO. The proposed Appendix I agreement between ITC Midwest and the Midwest ISO would

⁵² See *American Transmission Company*, 111 FERC ¶ 61,350 (2005).

establish ITC Midwest as an Appendix I member. In order to qualify for Appendix I membership, ITC Midwest must meet the independence criteria established by the Commission.

77. ITC Midwest states that the proposed Appendix I agreement is derived substantially from the principles in Appendix I to the Midwest ISO TO Agreement and from comparable agreements and tariff provisions governing participation of other independent transmission companies in the Midwest ISO that have been approved by the Commission, including International Transmission's Appendix I agreement with the Midwest ISO. In support of Appendix I membership, ITC Midwest submits that it will be a fully independent, stand-alone transmission company, pointing out that ITC Holdings has adopted rigorous provisions to secure ITC Midwest's independence. ITC Midwest argues that these same provisions were relied upon by the Commission to confirm the independence of International Transmission.⁵³ It argues that, as a result, ITC Midwest would not be affiliated with a traditional public utility company that makes energy sales to captive retail customers, nor would it be affiliated with any entity that owns or operates generation assets. ITC Midwest further maintains that the composition of ITC Holdings' Board of Directors as well as the corporate governance structure of ITC Holdings supports ITC Midwest's contention that it will be truly independent.

i. Protests

78. Municipal Coalition argues that certain provisions of the proposed Appendix I agreement depart from the principles in Appendix I to the Midwest ISO TO Agreement and from what the Commission has approved in the past, even for International Transmission. Further, Municipal Coalition notes that when the Commission accepted International Transmission's Appendix I agreement in 2001,⁵⁴ it expressly declined to act on provisions in the agreement at that time because International Transmission was still a wholly-owned subsidiary of DTE Energy Company, and the Commission believed that it would be more appropriate to act on those provisions when International Transmission became independent of market participants. Municipal Coalition states that it does not appear that the Commission has made any determinations with respect to the International Transmission Appendix I agreement since it was initially accepted on

⁵³ ITC Midwest notes that in its order approving ITC Holdings' initial public offering, the Commission found that measures adopted by ITC Holdings, including restrictions on market participants holding 5 percent or more of the common stock of ITC Holdings, assured its independence from market participants. Application at 51, citing *ITC Holdings Corp.*, 111 FERC ¶ 61,149, at P 15, 25 (2005) (*IPO Order*).

⁵⁴ *International Transmission Company*, 97 FERC ¶ 61,328 (2001) (*International Transmission*).

December 20, 2001, nor that International Transmission has requested such Commission action. Several issues with respect to International Transmission's Appendix I agreement have therefore not been resolved.

79. Municipal Coalition takes issue with section 4.2 of the ITC Midwest Appendix I agreement, which states that "ITC Midwest shall have the right to establish tariff rates, terms and conditions of service under the Midwest ISO Tariff for transactions within the ITC Midwest Zone." Municipal Coalition similarly takes issue with section 3.1 of the proposed agreement, which would allow ITC Midwest to file its own mechanism for determining responsibility for energy losses. Municipal Coalition notes that the Commission allowed TRANSLink to file its revenue requirement and incentive rates—not rates, terms, and conditions—only for transactions with both source and sink in the TRANSLink footprint, and only after consultation with the Midwest ISO. In doing so, the Commission cautioned that "[i]n designing a separate schedule to be included in the Midwest ISO tariff, TRANSLink must minimize... differences."⁵⁵ With respect to energy losses, Municipal Coalition points out that in accepting a nearly identical proposal by an independent transmission company in 2002, the Commission indicated that it considered the proposal a temporary fix and that in the long-term there should be a single methodology for determining energy losses in the Midwest ISO region.⁵⁶ Municipal Coalition argues that if ITC Midwest is allowed to unilaterally set the rates, terms and conditions for service within its zone without regard for whether variations from the Midwest ISO Tariff are necessary, the unity of the Midwest ISO region will be undermined. ITC Midwest's authority over rates, terms and conditions should be restricted consistent with *TRANSLink I* and *Alliance*.

80. Next, Municipal Coalition notes that section 1.3 of the proposed Appendix I agreement has a 'most favored nation' clause providing ITC Midwest the option, subject to the Commission's approval, to amend the agreement to incorporate any superior terms that the Midwest ISO provides to others for similar services. Municipal Coalition comments that no party objected to a similar provision in the International Transmission Appendix I agreement, and the Commission made no remarks on the provision when it accepted that agreement in 2001. However, two years later, the Commission refused to allow TRANSLink to include an almost identical most favored nation clause in its arrangement with the Midwest ISO, finding that it would impose an undue administrative

⁵⁵ Municipal Coalition Protest at 81 (*citing TRANSLink Transmission Company*, 99 FERC ¶ 61,106, at 61,464 (*TRANSLink I*), *order on reh'g*, 101 FERC ¶ 61,140 (*TRANSLink II*) (2002)).

⁵⁶ Municipal Coalition Protest at 86-87, *citing Alliance Companies*, 99 FERC ¶ 61,105, at 61,440 (2002) (*Alliance*).

burden and create contract uncertainty.⁵⁷ The Municipal Coalition argues that the burden and risk of contract uncertainty are no less now than in 2003, and the Commission therefore should reject this provision as before.

81. Municipal Coalition also has concerns with section 6.1 of the proposed Appendix I agreement, which states that “Midwest ISO approval is not required for the ITC Midwest plan (subject to any dispute resolution), which shall become part of the Midwest ISO regional plan.” In contrast, Municipal Coalition states, section 10 of Appendix I to the Midwest ISO TO Agreement expressly provides for dispute resolution as to whether an independent transmission company’s plan may be incorporated into the Midwest ISO plan if the Midwest ISO disagrees with the plan. According to Municipal Coalition, ITC Midwest’s Appendix I goes a long way toward carving its plans out of the Midwest ISO’s planning process and any “least cost” discipline that process might supply. If left to its own devices, ITC Midwest has economic incentives to favor “wires” over “non-wires” solutions. Municipal Coalition notes that the Commission has recognized that this bias may lead to over-building; the Commission found that allowing an independent transmission company to plan expansions subject to RTO veto only if they “impair reliability or Total Transfer Capability... could result in transmission expansion that, although consistent with reliability, may not treat transmission (wires) and non-wire (i.e., generation and perhaps demand side actions) solutions objectively and neutrally if [the RTO] does not consider least cost planning in its approval process.”⁵⁸

82. Municipal Coalition argues that in failing to address clearly disagreements between the Midwest ISO and ITC Midwest regarding ITC Midwest’s plan and/or inclusion of ITC Midwest’s plan in the Midwest ISO plan, the Midwest ISO’s ability to develop an effective and efficient regional transmission plan as intended in Order No. 2000⁵⁹ could be severely undermined. The Commission should require the Applicants to revise the ITC Midwest Appendix I agreement to give Midwest ISO clear ultimate responsibility for planning throughout the Midwest ISO region. At a minimum, the Commission should require that the provision for resolving disputes over whether ITC

⁵⁷ Municipal Coalition Protest at 87-88 citing *TRANSLink Development Company*, 102 FERC ¶ 61,033 at P 25 (2003) (*TRANSLink Development*).

⁵⁸ Municipal Coalition Protest at 83-84, citing *Avista Corp.*, 95 FERC ¶ 61,114, at 61,341 (*Avista*), *reh’g granted in part*, 96 FERC ¶ 61,058, *clarified*, 96 FERC ¶ 61,265 (2001).

⁵⁹ *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh’g*, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (2000), *aff’d sub nom. Pub. Util. Dist. No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

Midwest's plan is incorporated into the Midwest ISO regional plan be made consistent with what Appendix I to the Midwest ISO TO Agreement requires. Municipal Coalition also requests that the Commission clarify that ITC Midwest is subject to the joint planning requirement that applies to transmission owners in an RTO under Attachment K to the Order No. 890 *pro forma* open access transmission tariff.

83. Finally, Municipal Coalition states that, as proposed, ITC Midwest can use its own plan with assured revenue recovery through its zonal rate. Unlike vertically integrated TOs, ITC Midwest is not accountable to state commissions (or transmission customers in its zone) as to the level of its transmission rates. Because it has no incentive to keep its zonal transmission rates low, ITC Midwest may not be motivated to seek broader cost allocation. Therefore, Municipal Coalition requests that the Commission require ITC Midwest to participate in the Midwest ISO transmission expansion protocol in Attachment FF of the Midwest ISO Tariff for all projects potentially eligible for allocation beyond the ITC Midwest zone, to ensure maximum cost spreading.

ii. Answer

84. ITC Midwest argues that the numerous criticisms of the proposed Appendix I agreement should be rejected, given ITC Midwest's commitment to execute the Midwest ISO TO Agreement and its status as an independent transmission company. It argues that it is appropriate for it to have authority to file tariff rates, terms and conditions of service for transactions within the ITC Midwest zone, noting that this provision is contained in International Transmission's Appendix I agreement and that any exercise of this reserved authority will require Commission approval. ITC Midwest notes that the provision for filing an energy loss methodology is derived from section 6.1 of Appendix I to the Midwest ISO TO Agreement and that the provision requires that any mechanism implemented by ITC Midwest not affect losses in areas outside of the ITC Midwest zone.

85. With respect to the most favored nation clause, ITC Midwest states that the provision is derived from the International Transmission Appendix I agreement. In support of the provision, ITC Midwest notes that the Midwest ISO TOs have not objected to the provision and argues the provision actually relieves an administrative burden and assures nondiscriminatory treatment of all Midwest ISO members.

86. Finally, ITC Midwest states that it will fully participate in the Midwest ISO regional transmission expansion planning protocol and comply with any planning requirements of Order No. 890. In addition, ITC Midwest will have to comply with Reliability Standards established by the Electric Reliability Organization and to act in accordance with good utility practice. Finally, ITC Midwest asserts that Municipal Coalition's concerns about cost allocation for transmission projects are beyond the scope of this proceeding. It states that any cost allocation decisions for ITC Midwest's transmission projects will comply with Commission-approved cost allocation mechanisms.

iii. Commission Determination

87. As the Commission found in the *IPO Order*, ITC Holdings' ownership structure will prevent market participants from being able to influence or control International Transmission and thus undermine its independence.⁶⁰ Therefore, we find that ITC Midwest, as proposed, would be a fully independent, stand-alone transmission company eligible for an Appendix I relationship with the Midwest ISO.

88. We will approve the proposed Appendix I agreement without modification, as discussed below. Regarding the right to make filings under section 205 as to the rates, terms and conditions for transactions within the ITC Midwest zone, we find that changes to the proposed agreement are not necessary to ensure that the rates for service under the Midwest ISO's Tariff are just and reasonable. As ITC Midwest notes, no proposal will become effective without a Commission order accepting it. In evaluating any proposals regarding transactions within the ITC Midwest zone, the Commission will look at the relationship of the proposal to the rates, terms and conditions for service outside of the ITC Midwest zone to ensure that the resulting rates, terms and conditions for service under the Midwest ISO Tariff are just and reasonable, consistent with the Commission's policies for regional transmission service provided by RTOs.

89. Similarly, we will not require removal of the most favored nation clause. As ITC Midwest notes, this provision is derived from International Transmission's Appendix I agreement, and no Midwest ISO TOs have objected to the provision. While we rejected such a provision in *TRANSLink Development*, we did so believing that such language would impose undue administrative burden and create contract uncertainty. However, we note that the most favored nation clause in International Transmission's Appendix I agreement has never been invoked during the six years that it has been in effect and, thus, has not resulted in such problems. Moreover, even if invoked by ITC Midwest, proposed amendments to its Appendix I agreement must be filed under section 205 and may not take effect absent approval by the Commission. In evaluating such proposals, the Commission will evaluate the impact of the proposal on the overall agreement to ensure that the amendment would not result in the agreement becoming unjust, unreasonable or unduly discriminatory.

90. Under section 6.1 of the proposed Appendix I agreement, ITC Midwest would be responsible for planning its system as well as for the construction of new facilities. The provision calls for informing and coordinating these actions with the Midwest ISO to the maximum extent practical, but the Midwest ISO's approval is not required for ITC Midwest's plan (subject to dispute resolution) to become part of the Midwest ISO regional plan. However, if the Midwest ISO believes that an ITC Midwest planned

⁶⁰ *IPO Order*, 111 FERC ¶ 61,149 at P 25.

facility will have a material impact on facilities in the Midwest ISO outside of the ITC Midwest system, that aspect of the ITC Midwest plan shall not be implemented until the Midwest ISO has a reasonable time to review it and any disputes are resolved. Projects included in any ITC Midwest plan shall only qualify for cost allocation to zones other than the ITC Midwest zone under the regional cost allocation provisions in Attachment FF of the Midwest ISO Tariff if the projects have been included in the Midwest ISO's transmission expansion planning protocol in Attachment FF of the Midwest ISO Tariff. Finally, section 6.2 states that nothing in section 6 is intended to change the responsibility of the Midwest ISO to develop a regional plan, including the ITC Midwest facilities, as provided in the Midwest ISO TO Agreement.

91. Municipal Coalition argues that the Commission should require the Applicants to revise the ITC Midwest Appendix I agreement to clearly give the Midwest ISO ultimate responsibility for planning throughout the Midwest ISO region in order to ensure effective and efficient regional transmission planning. In *Avista*, we expressed concern that independent transmission companies may have incentives to pursue transmission projects even if less expensive alternatives exist and directed the applicants in that proceeding to address how least cost options would be considered as part of their overall planning and expansion proposal. We believe that the Midwest ISO's transmission expansion planning protocol and the transmission planning reforms adopted by Order No. 890 will provide sufficient opportunities to ensure that planning and construction are conducted with appropriate consideration of least cost options. In addition, as we discuss below, the planning process will provide sufficient opportunity for Municipal Coalition and other affected parties to ensure that ITC Midwest-planned projects receive consideration for regional cost sharing under the Midwest ISO Tariff.

92. Under the Midwest ISO's transmission expansion planning protocol in Attachment FF of the Midwest ISO Tariff, the Midwest ISO coordinates with the TOs to develop a comprehensive regional plan designed to reflect the most efficient and cost-effective solutions to meet base-line reliability needs, new requests for generation interconnection and transmission delivery service, and projects that provide regional economic benefits. Only projects included in that planning process and meeting the reliability and economic benefit criteria are eligible for regional cost sharing under Attachment FF. As required by Order No. 890, this planning process, as well as any planning conducted by the Midwest ISO TOs,⁶¹ must be transparent and open to all affected parties, and must

⁶¹ In Order No. 890, the Commission recognized that RTO and ISO planning processes may focus principally on regional problems and solutions, not local planning issues that may be addressed by individual transmission owners. Thus, the Commission required individual transmission-owning members of RTOs and ISOs to comply with the planning reforms adopted in the Final Rule to the extent that they perform transmission planning within the RTO or ISO. *See* Order No. 890 at P 440.

consider least cost options, including non-wires alternatives. This open, transparent planning will provide affected parties sufficient opportunities to ensure that projects in ITC Midwest's transmission plans are submitted for consideration under the Midwest ISO's transmission expansion planning protocol where appropriate.⁶² It will also allow affected parties to identify any instances in which the independence of ITC Midwest's planning may be in question, and seek to resolve such situations either in a consensual manner or by filing a formal complaint with the Commission.

93. We direct the Midwest ISO to file a revised Appendix I Agreement designated in compliance with Order No. 614, within 30 days of the close of the transaction.

C. Section 203 Analysis

94. Section 203(a)(4) of the FPA requires the Commission to approve a transaction if it determines that the transaction will be consistent with the public interest. Under the Commission's regulations, its analysis of whether a transaction will be consistent with the public interest generally involves consideration of three factors: (1) the effect on competition, (2) the effect on rates, and (3) the effect on regulation.⁶³ Section 203 also requires the Commission to find that the transaction "will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest."⁶⁴ The

⁶² Nothing in Attachment FF of the Midwest ISO Tariff precludes parties, including TOs, from supporting the construction of projects where either the reliability or economic benefit criteria necessary for regional cost sharing in Attachment FF are not satisfied, or where no regional cost sharing is sought by the parties, if the projects provide benefits that are sufficient for the parties to support the project financially without regional cost-sharing.

⁶³ *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (*Merger Policy Statement*). See also *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001); *FPA Section 203 Supplemental Policy Statement*, 72 Fed. Reg. 42,277 (Aug. 2, 2007), FERC Stats. & Regs. ¶ 31,253 (2007); *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

⁶⁴ 16 U.S.C. § 824b(a)(4) (2000), *amended by Energy Policy Act of 2005*, Pub. L. No. 109-58, § 1289, 119 Stat. 594, 982-83 (2005).

Commission's regulations establish verification and informational requirements for applicants that seek a determination that a transaction will not result in inappropriate cross-subsidization or an inappropriate pledge or encumbrance of utility assets.⁶⁵

1. Effect on Competition

a. Applicants' Analysis

95. Applicants state that the Transaction will have no adverse effect on competition and does not require a horizontal or vertical analysis. They state that the transmission facilities now owned by IPL will be owned by ITC Midwest, an independent transmission company that is not affiliated with any market participant generating or marketing wholesale or retail electricity or owning, operating, or controlling inputs to electricity production. They also argue that because the Transaction involves only an acquisition of transmission assets, and no transfer of generation facilities or inputs to electric power generation, it raises neither horizontal nor vertical market power concerns.

96. Applicants state that the transmission facilities will continue to be under the functional control of the Midwest ISO. The Midwest ISO will continue to provide open, non-discriminatory access to these facilities under the Midwest ISO Tariff. With independent operation of, and open access to, the ITC Midwest transmission facilities thus assured, and with independently-owned transmission being an even greater percentage of the transmission system covered by the Midwest ISO, the Transaction will promote the continued development of competitive wholesale power markets.

b. Protest

97. The IA Consumer Advocate disputes Applicants' contention that the Transaction will promote competition and concludes that it will have a neutral impact on competition. It argues that IPL is already committed to supporting open and non-discriminatory access to its transmission facilities under the Midwest ISO Tariff as well as the development of a robust transmission grid, both of which advance competition. ITC Midwest's transmission plans are basically simply to implement IPL's transmission plans and to meet IPL's transmission/distribution service obligations. The IA Consumer Advocate states that the Iowa Board has authority to encourage IPL to make investments in transmission and distribution facilities. The transaction would make IPL's Iowa consumers entirely dependent on ITC Midwest's investment priorities. The IA Consumer Advocate also argues that if the Transaction produces higher rates for existing

⁶⁵ 18 C.F.R. § 33.2 (2007).

distribution and transmission facilities in exchange for ITC Midwest's intention to implement IPL's existing transmission/distribution plans and obligations, the Transaction does not improve competition.

98. Municipal Coalition argues that the ASA, the DT Interconnection Agreement, and the Transition Agreement create a situation in which IPL will be a favored customer. The provisions of the DT Interconnection Agreement discussed above, including the third-party beneficiary language, could lead to an undue preference in favor of IPL and must be revised so that other customers can hold ITC accountable contractually in the same way that IPL can under this agreement.⁶⁶ Municipal Coalition also argues that the capital project schedule provisions of Transition Agreement section 1(f) discussed above give IPL advantages over other market participants.⁶⁷

99. Finally, Municipal Coalition states that section 7.13(b) of the ASA permits ITC Midwest to withdraw from the Midwest ISO during the first five years after closing, but only with IPL's consent. It argues that this gives ITC Midwest reasons to give more weight to IPL's views on RTO participation than the views of state commissions or network customers. This encourages ITC Midwest to favor IPL. Municipal Coalition states that ITC Midwest should be required to stay in the Midwest ISO for at least five years unless all Midwest ISO customers serving load in the ITC Midwest area consent to an early withdrawal.

c. Applicants' Answer

100. Applicants state in response that the IPL-identified transmission projects are merely a baseline for what will be needed, and ITC Midwest will make investments in economically-beneficial transmission expansion that IPL does not plan to make. Applicants state that ITC's other subsidiaries have aggressively invested in the transmission grid. They state that ITC Midwest expects to find additional opportunities and that it will make needed investments that IPL would not have made. IPL's Iowa consumers would not be left entirely dependent on ITC Midwest's priorities for investment. ITC Midwest's priority will be meeting the needs of all users of the system, and there will be no internal competition for capital needed to invest in the operation, maintenance, and necessary expansion of the system. Applicants maintain that ITC Midwest is an independent entity with no bias to build or not build for anyone.

101. Applicants note that ITC Midwest will participate fully in the Midwest ISO's Transmission Expansion Plan regional transmission planning process, which provides

⁶⁶ *See supra* P 71-72.

⁶⁷ *See supra* P 65-66.

opportunities for interested parties to shape transmission proposals. They also note that the Midwest ISO regional planning process includes multiple levels of stakeholder review and input. Finally, Applicants state that the transmission needed to serve IPL's retail customers is assured in the DT Interconnection Agreement. Under that agreement, ITC Midwest will have a public utility duty to operate, maintain, plan, and construct adequate transmission and take other actions needed to assure that the needs of all load-serving entities connected to its system are met.

102. In response to Municipal Coalition, Applicants make many of the arguments described above in connection with the analysis of related contracts under section 205. Applicants state that the DT Interconnection Agreement is a distribution-to-transmission agreement comparable to agreements that exist between Detroit Edison Company and *ITC Transmission* and between Consumers Energy Company and METC. They state that the third-party beneficiary language in the DT Interconnection Agreement is a standard contractual provision found in other distribution transmission agreements accepted by the Commission.⁶⁸ Applicants state that Municipal Coalition seems to dismiss the non-discrimination mandates of the FPA. The existence of an agreement with IPL does not suggest that ITC Midwest will act in a discriminatory manner.

103. On the issue of possible withdrawal from the Midwest ISO, Applicants note that ITC Midwest has proposed to become a signatory to the Midwest ISO Transmission Owners Agreement, and ITC Midwest's withdrawal from the Midwest ISO would be governed by that agreement. IPL thus would not have a privileged position on this matter.

104. Applicants state that section 1(f) of the Transition Agreement does not imply that ITC Midwest is not interested in communicating or working with other transmission customers or that it is not committed to acting in a non-discriminatory manner. They note that the Transition Agreement is a temporary agreement meant to assist with the smooth transition of transmission functions to ITC Midwest.

d. Commission Determination

105. In analyzing whether a transaction will adversely affect competition, the Commission first examines its effects on concentration in generation markets or whether the transaction otherwise creates an incentive to engage in behavior harmful to competition, such as the withholding of generation (horizontal concerns). Second, the Commission considers the vertical combination of upstream inputs, such as transmission or natural gas, with downstream generating capacity. Applicants have shown that the Transaction will not have an adverse effect on competition in either respect. First, the

⁶⁸ Applicants cite *ITC Holdings Corp* and *Trans-Elect I*.

Transaction involves no generation assets. Neither ITC Midwest nor any of its affiliates own or control any generating assets, and ITC Midwest is not affiliated with any market participant. There thus will be no adverse effect on generation market conditions. Second, the Transaction creates no new vertical combinations of assets, and the transmission facilities that will be transferred in the Transaction will continue to be under the operational control of the Midwest ISO.

106. While we believe that Applicants have demonstrated that the Transaction promotes competition, we note in response to the IA Consumer Advocate that a “neutral” impact on competition is sufficient for purposes of section 203.⁶⁹

107. Municipal Coalition argues that IPL as a customer will have too much influence over ITC Midwest and that this will undermine competition, based on its review of the DT Interconnection Agreement, the Transition Agreement and the ASA. As we discussed above, with the conditions we have required, these contracts are just and reasonable and do not harm competition.⁷⁰ We disagree with Municipal Coalition that IPL will be a favored customer of ITC Midwest. Municipal Coalition claims that the DT Interconnection Agreement will harm competition because of the third-party beneficiary language in section 27.3 that Municipal Coalition characterizes as unduly discriminatory. However, that language cannot override the rights to non-discriminatory treatment that other parties have under the FPA. It also cannot override the Midwest ISO Tariff, which prevents undue discrimination by transmission owners. Municipal Coalition thus has not shown that the DT Interconnection Agreement will adversely affect competition.

108. Municipal Coalition’s arguments concerning the provisions on withdrawal from the Midwest ISO in section 7.13(b) of the ASA do not raise an issue regarding harm to competition. In addition, Municipal Coalition has not explained the likelihood that ITC Midwest would wish to withdraw from Midwest ISO, the likelihood that IPL would object, or what discriminatory conduct section 7.13(b) of the ASA could lead to, making the entire matter speculative. We also note that ITC Midwest gives its participation in the Midwest ISO as one of the reasons we should approve the Transaction and that because the costs of participation in the Midwest ISO are borne by transmission customers, ITC Midwest will have little or no incentive to withdraw from the Midwest ISO. For these reasons, we reject Municipal Coalition’s argument that section 7.13(b) of the ASA would undermine competition.

⁶⁹ See *Pacific Power & Light Co. v. FPC*, 111 F.2d 1014, 1016 (9th Cir. 1940); *Northeast Utilities Service Co. v. FERC*, 993 F.2d 937, 945 (1st Cir. 1993).

⁷⁰ See *supra* P 68-69, 74-75.

109. We have addressed Municipal Coalition's arguments regarding section 1(f) of the Transition Agreement above.⁷¹ We conclude that section 1(f) of the Transition Agreement will not harm competition when subject to the conditions we have specified.

2. Effect on Rates

a. Applicants' Analysis

110. Applicants state in their application that the Transaction will not have an adverse effect on rates because ITC Midwest offers standard ratepayer protection commitments consistent with Commission precedent. Specifically, Applicants state that: (i) no acquisition premium will be recovered in rates, nor will ITC Midwest collect through transmission rates any Transaction-related costs that exceed demonstrated Transaction-related savings for a period of five years; (ii) under the proposed forward-looking application of Attachment O, ITC Midwest's charges for transmission service will not change until January 1, 2009; (iii) the rate effects of the Transaction for wholesale ratepayers and transmission customers are comparable to the rate effects associated with similar independent transmission transactions previously approved by this Commission; and (iv) the economic benefits of the Transaction are substantial, and any rate impacts resulting from the Transaction are consistent with the public interest and are not adverse.

b. Protests

111. Municipal Coalition states that the Application does not calculate the Transaction's effect on rates.⁷² The IA Consumer Advocate argues that the cost-benefit analysis sponsored by Applicants in the Iowa Board proceeding concerning the Transaction demonstrates that the transmission revenue requirement for 2008 through 2012 for ITC Midwest will be \$90.1 million higher than if IPL kept these facilities. While this effect may be mitigated somewhat by the resulting reduction in cost of capital for IPL, the amount by which ITC Midwest's forecasted costs exceed IPL's is still nearly \$60 million over this five-year period. Thus transmission users will experience a rate increase of over 20 percent annually. Municipal Coalition makes a similar estimate. The IA Consumer Advocate states that Applicants offer no substantive or quantitative

⁷¹ *See supra* P 68-69.

⁷² We note that Jo-Carroll Energy, Inc. filed a protest on August 16, 2007 in response to negotiations it stated it understood were under way between Applicants and Dairyland to alter the Transaction. Applicants filed a Motion for Leave to Answer and Answer on August 31, 2007. Jo-Carroll Energy, Inc. withdrew its protest on September 21, 2007, and Applicants withdrew their response on September 25, 2007.

analysis of these effects on rates, including how the Transaction will affect the users of transmission facilities who do not purchase electricity from IPL, how the offsetting savings are measured, and what the process is.

112. Dairyland also states that Applicants have not shown that the economic benefits they expect the Transaction to create will outweigh any adverse rate effects of the Transaction. It states that the increased investment in both transmission and generation assets that the Applicants maintain will result from the Transaction are not the types of benefits the Commission was referring to when it said in the *Merger Policy Statement* that a merger that is detrimental in certain respects can still be in the public interest if it produces countervailing benefits. Dairyland states that the countervailing benefits the Commission identified in the order Applicants cite, *TRANSLink I*, were reductions in rate pancaking and increases in the competitive options for transmission customers in the Midwest resulting from the increase in the size and scope of the Midwest ISO through the addition of TRANSLink.

113. Municipal Coalition challenges Applicants' position that under their proposal, ITC Midwest's charges for transmission service will not change until January 1, 2009. Midwest Coalition maintains that Applicants' filings with the Iowa Board and the Commission make clear that ITC Midwest's collections commencing January 1, 2008 are subject to true-up, with interest, so that ITC Midwest will ultimately collect a 2008 revenue requirement that is inflated by the proposed 13.88 percent return on equity, 60 percent equity ratio, ADIT adjustment, etc. Municipal Coalition states that while ratepayers may initially be billed under IPL's Attachment O from January 1, 2008 to January 1, 2009, the effective revenue requirement for that period will be the trued-up revenue requirement and rates reflecting ITC Midwest's actual costs for 2008. The resulting true-up amount for 2008 will be collected from ratepayers, with interest, starting January 1, 2010, on top of ITC Midwest's estimated revenue requirement for 2010. Municipal Coalition maintains that the purpose of the true-up with interest is to make ITC Midwest's increased revenue requirement effective as of January 1, 2008.

114. Municipal Coalition challenges Applicants' position that the Transaction's effects on transmission rates are similar to those in prior cases involving the creation of independent transmission companies. Municipal Coalition states that the cases Applicants cite, *ITC Holdings* and *Trans-Elect I and II*, both involved multi-year rate freezes; sought smaller ADIT adjustments; involved incentive equity returns that were closer to the then-current cost-based level and were within the then-current range of proxy returns; and met with little intervenor protest as to the effect on transmission rates. Municipal Coalition states that in accepting METC's ADIT adjustment on rehearing, the Commission gave significant weight to the uncontested nature of the proposal and the fact that the applicants had entered into stipulations with the transmission-dependent utilities and state commissions. Municipal Coalition maintains that Applicants have not done this and have attempted to disguise their rate increase.

115. Municipal Coalition and Dairyland contest Applicants' claim that they are not seeking to recover the acquisition premium in rates. Municipal Coalition states that ITC Holdings' President and Chief Executive Officer Joseph L. Welch has testified that the rates ITC Midwest seeks will fund ITC Midwest's payment of a premium to IPL through indirect recovery of the premium through excessive returns. Municipal Coalition argues that given the excessive nature of the requested ROE, the fact that ITC Midwest will not seek direct recovery of the acquisition premium does not answer ratepayer concerns. Dairyland maintains that ITC Midwest is proposing its ROE incentive as a means of recovering the acquisition premium indirectly.

116. Great River states that the Commission should require ITC Midwest to assume the burden of proof in any dispute regarding ITC Midwest's recovery of any transaction-related costs through its transmission rates.

c. Answer

117. In their answer, Applicants acknowledge that the Transaction will have some rate effects. Applicants make several commitments to address these effects, including ITC Midwest's commitment not to include the acquisition premium in rates and not to collect Transaction-related costs that exceed Transaction-related savings. They note that ITC Midwest has committed to the Iowa Board not to recover the first \$15 million of Transaction-related costs and that recovery of costs above that amount will be subject to Commission approval. Given that transmission costs, on average, account for only ten percent of the delivered cost of electricity, even the 20 percent increase in transmission costs claimed by Municipal Coalition would translate into only a two percent increase in the total cost of electricity. That amount likely will be more than offset by savings from reduced congestion, access to lower cost power, and other benefits, as has occurred in connection with International Transmission's projects in Michigan.

118. With respect to the issue of net benefits raised by Dairyland, Applicants identify the benefit that will outweigh any adverse effect as "the establishment of a new, independent, transmission-only company with the capability and focus to develop, operate, and maintain needed transmission infrastructure in Iowa" ⁷³

119. In response to Great River, Applicants commit that in seeking to recover Transaction-related costs, ITC Midwest will make an informational filing with the Commission in which it will assume the burden of proving that recovery is just and reasonable.

⁷³ Applicants' Answer at 19.

d. Commission Determination

120. Our analysis of rate effects under section 203 of the FPA differs from the analysis of whether rates are just and reasonable under section 205 of the FPA, something that we addressed above. Our focus here is on the effects that the Transaction itself will have on rates, whether those effects are adverse, and whether any adverse effects will be offset by benefits that are likely to result from the Transaction. We note that ITC Midwest will bear the burden of proof in a future section 205 filing if it seeks to show offsetting benefits in order to recover any merger related costs.

121. The IA Consumer Advocate has misunderstood the nature of our analysis of a transaction's effect on rates under section 203. Arguments pertaining to cost-benefit analysis are not relevant here. The Commission noted in the *Merger Policy Statement* that in the past, it had investigated an applicant's claims about costs and benefits and sought to determine whether costs are likely to exceed benefits. However, the Commission noted that such investigations were frequently time-consuming and that there had been considerable controversy over whether estimates of costs and benefits are truly meaningful, as well as other controversies concerning such procedures.⁷⁴ The Commission therefore stated in the *Merger Policy Statement* that “[r]ather than requiring estimates of somewhat amorphous net merger benefits and addressing whether the applicant has adequately substantiated those benefits, we will focus on ratepayer protection.”⁷⁵ To that end, the *Merger Policy Statement* described various mechanisms that may be acceptable means of protecting ratepayers in particular cases, such as a hold harmless commitment for a significant period of time following the merger.

122. The IA Consumer Advocate's arguments about cost-benefit analysis reprise many of the problems that convinced the Commission that this approach is unproductive for these purposes. Our concern ordinarily is that ratepayers receive protection against actual adverse rate effects, although, as discussed below, in cases such as this one, some rate increases are acceptable because they are offset by other benefits. This is best achieved through specific protection mechanisms. Applicants have stated that no acquisition premium will be recovered in rates, nor will ITC Midwest collect through transmission rates any Transaction-related costs that exceed demonstrated Transaction-related savings for a period of five years as a result of its hold harmless commitment. This commitment

⁷⁴ *Merger Policy Statement* at 31,122.

⁷⁵ *Id.* at 30,124.

is consistent with the types of hold harmless provisions that the Commission has found sufficient to protect against adverse effects of a transaction on rates.⁷⁶

123. We disagree with Dairyland that increased investment in both transmission and generation assets cannot be a countervailing benefit that allows a transaction that may increase rates to be consistent with the public interest. On the contrary, increased investment in transmission infrastructure is one of the reasons it has been Commission policy to encourage independent transmission companies. In passing section 219 of the FPA, Congress made clear that it considers increased investment in transmission to be an important national goal. In addition, we disagree that the present case can be distinguished from *TRANSLink I* in the manner Dairyland proposes. First of all, increased investment in transmission ultimately increases competitive options for customers by increasing the ability of suppliers to reach the market. A primary reason that reducing rate pancaking was an important consideration in *TRANSLink I* was that a “wider area served by a single rate means more generation is economically available to any customer which means greater competition for energy.”⁷⁷ Expansion of transmission infrastructure achieves this goal also, and for this reason *TRANSLink I* supports our conclusion here, although the means by which that goal would be achieved were different.

124. We note that the benefits derived from expanding transmission infrastructure do not easily lend themselves to precise quantitative analysis, and we reject the IA Consumer Advocate’s objection on that point. Applicants have stated that no acquisition premium will be recovered in rates, and ITC Midwest will not collect through transmission rates any Transaction-related costs that exceed demonstrated Transaction-related savings for a period of five years. This being the case, and given the widely recognized need for increased transmission investment, the Commission finds that any increased costs of ITC Midwest attributable to prudent transmission investment do not make the Transaction contrary to the public interest.

125. Our denial of the requested ROE moots in part Municipal Coalition’s challenge to Applicants’ position that the Transaction’s effects on rates are consistent with *ITC Holdings* and *Trans-Elect I and II*. In addition, while we reject the notion that rate incentives for an independent transmission company acquiring facilities are an indirect means of recovering an acquisition premium, our action above on the requested ROE

⁷⁶ The Commission has accepted five-year commitments to hold customers harmless from rate increases as an appropriate period of time on limits to rate increases following mergers. See *Duke Energy Corp. and Cinergy Corp.*, 113 FERC ¶ 61,297 (2005); *PNM Resources, Inc.*, 110 FERC ¶ 61,204 (2005).

⁷⁷ Order No. 2000 at 31,175.

moots the arguments of Midwest Coalition and Dairyland that ITC Midwest is seeking to recover an acquisition premium in this case through its proposed ROE. Further, as discussed above, the effect on rates associated with zeroing out the ADIT upon transfer of the assets is not out of line with the corresponding effects resulting from the transactions approved in *ITC Holdings* and *Trans-Elect I and II*. We find that these effects are offset by the benefits of independent ownership and operation that will result from the Transaction, which will result in the same level of independence resulting from the transactions approved in *ITC Holdings* and *Trans-Elect I and II*.

126. Regarding Great River's request that in implementing their hold harmless commitment, Applicants bear the burden of proof as to Transaction-related costs and savings, we note that Applicants have committed that ITC Midwest will make an informational filing with Commission in which it will assume the burden of proof that recovery is appropriate.

127. Finally, we note that no state commission has protested the rate effects of the Transaction.

128. In summary, Applicants offer standard hold harmless provisions for customers, stating that no acquisition premium will be recovered in rates, nor will ITC Midwest collect through transmission rates any Transaction-related costs that exceed demonstrated Transaction-related savings for a period of five years. In addition, they note that the Transaction will produce significant economic benefits, such as reduced congestion costs and access to lower-cost power. Applicants also acknowledge that the Transaction will have rate effects. However, the Commission has recognized that the creation of an independent, stand-alone transmission company can result in significant benefits for customers that can outweigh any rate effect a transaction would create.⁷⁸ Applicants have shown that such benefits exist in this case.

3. Effect on Regulation

a. Applicants' Analysis

129. Applicants state that the Transaction will have no adverse effect on regulation by the Commission, the Iowa Board, the Illinois Commission, or the Minnesota Commission. The rates, terms and conditions of service for wholesale customers served by the transmission facilities ITC Midwest proposes to acquire will continue to be regulated by this Commission, and functional control over these facilities will remain with the Midwest ISO. In addition, Applicants state that the Transaction raises no

⁷⁸ See, e.g., *ITC Holdings*, 102 FERC ¶ 61,182 at P 94; *Trans-Elect II*, 98 FERC ¶ 61,368 at 62,590.

concerns about state regulation. The retail rates for electric power sales and distribution in Iowa and Minnesota will continue to be regulated by the Iowa Board and the Minnesota Commission, respectively. The Transaction will not affect retail rates in Illinois, since IPL has no retail electric distribution customers in the state. IPL likewise has no retail customers in Missouri, and Applicants maintain that the Transaction therefore does not raise retail rate concerns for that state.

b. Protests and Answer

130. Municipal Coalition states that it has concerns about the effect of the Transaction on state regulation. However, it recognizes that the Commission's policy is not to consider such effects where a state commission has authority to consider the Transaction. Municipal Coalition therefore states that it is raising its concerns in state proceedings rather than here.

131. The IA Consumer Advocate argues that the Transaction would take away the Iowa Board's statutory authority to regulate the rates for 34.5 kV and above distribution and transmission lines used to provide bundled retail electric service to IPL's Iowa customers. The Iowa Board's remaining jurisdiction over these components of electric service is unclear, so the Transaction would leave Iowa electric consumers in a more vulnerable position.⁷⁹ The IA Consumer Advocate states that as a matter of state law and policy, IPL delivers bundled electric retail service within its exclusive Iowa service territory, all aspects of which are currently subject to Iowa Board regulation. Iowa has not enacted a law enabling the unbundling and sale of transmission facilities. The IA Consumer Advocate states that IPL's transmission and distribution rates currently are set by the Iowa Board based primarily on historical data, which is subject to audit and investigation in accordance with Iowa contested case procedures, long-standing ratemaking practices required under Iowa law, and the investigatory authority of the IA Consumer Advocate and the Iowa Board. The use of a historical test year in Iowa ratemaking produces well-founded and reasonable rates while also rewarding operational efficiencies by the utility. The IA Consumer Advocate is concerned that Applicants' proposed move to setting rates based on projected costs will have a significant adverse effect on Iowa Board regulation that is inconsistent with the requirements of due process and Iowa law and policies. Finally, the IA Consumer Advocate states that it is not clear whether ITC Midwest would consider itself subject to Iowa laws governing transmission and distribution line safety and service quality.

⁷⁹ While the IA Consumer Advocate makes this point in connection with its arguments on the Transaction's effect on competition, we discuss it here in connection with the Transaction's effect on regulation.

132. Applicants argue in their answer that the IA Consumer Advocate has misunderstood the Commission's analysis in section 203 proceedings of the effects of a transaction on state regulation. Applicants state that under the *Merger Policy Statement*, the Commission will not ordinarily set this issue for a hearing where a state has authority to act on the Transaction. The Iowa Board, as well as the Illinois Commerce Commission and the Minnesota Public Utilities Commission, has authority to act on the acquisition. The IA Consumer Advocate's contention that the Iowa Board will lose jurisdiction overlooks the fact that the Iowa Board has jurisdiction over the Transaction and can address this issue directly. Applicants have filed for regulatory approvals in multiple states, and no state has argued that the Transaction would impair state regulation. IPL will continue to be regulated at the retail rate level by state commissions in states where IPL serves retail load, and the Commission will have jurisdiction over transmission services. There thus is no regulatory gap.

c. Commission Determination

133. We find that the proposed Transaction will not adversely affect Commission regulation. The Commission will be able to regulate ITC Midwest's rates, terms, and conditions of transmission service to the same extent that it has regulated those of IPL.

134. The IA Consumer Advocate has made a number of contentions regarding adverse effects on state regulation in Iowa. We note that the *Merger Policy Statement* specifies that "where the state commissions have authority to act on the merger, we intend to rely on the state commissions to exercise their authority to protect state interests."⁸⁰ The IA Consumer Advocate has not explained why the Iowa Board is unable to protect state interests. We note also that the Iowa Board has not filed a protest in this proceeding and that it has approved the Transaction, finding, among other things, that the Transaction will not be detrimental to the public interest.⁸¹ We thus find that the Transaction will not have an adverse effect on state regulation.

4. Cross-Subsidization

135. Applicants affirm that the proposed Transaction will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company. They state that ITC Midwest will be an independent stand-alone transmission company. It will not be affiliated with a traditional public utility company that engages in sales and distribution of electric power to captive retail customers. Nor will ITC Midwest be affiliated with a traditional public utility with

⁸⁰ *Merger Policy Statement* at 30,128.

⁸¹ *Iowa Board Order* at 84.

generation assets. The Transaction does not present the cross-subsidization concerns typically associated with transactions that involve traditional vertically integrated public utilities. Applicants verify that the proposed Transaction will not result in: (1) any transfers of facilities between a traditional utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, and an associate company; (2) any new issuances of securities by a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; (3) any new pledges or encumbrances of assets of a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; or (4) any new affiliate contracts between a non-utility associate company and a traditional utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements subject to review under section 205 and 206 of the FPA.

136. Applicants address the four-part test for evaluating cross-subsidization concerns. As demonstrated by the verifications made, the Transaction does not raise any concern with respect to cross-subsidization. We further note that no protests regarding cross-subsidization were filed.

5. Existing Contracts

137. CIPCO and Corn Belt note that they have a number of agreements with IPL. They do not oppose the Transaction, as long as the acquisition of IPL contracts by ITC Midwest, and the transfer of such contracts to ITC Midwest, is recognized as a legally enforceable assignment, and ITC Midwest is bound by the terms and conditions of these Commission-jurisdictional contracts. They request that any order approving the transfer of the agreements stipulate that none of the agreements will be substantively affected by the transfer. They also request that the order state that IPL must obtain consent from the counterparties to the agreements identified in Schedule 5.3(d) to the application.

138. Dairyland states that it has a General Transmission Facilities Installation Agreement and an Interconnection and Interchange Agreement with IPL that are grandfathered agreements (Grandfathered Agreements) under the Midwest ISO Tariff. Dairyland states that it cannot determine whether ITC Midwest intends to assume IPL's obligations under those agreements and that it therefore is not clear that the Transaction will have no effect on those contracts.

139. In response to the concerns expressed by CIPCO and Corn Belt, Applicants state that the transmission-related agreements with CIPCO, Corn Belt, and other customers will remain in place without material change, with ITC Midwest assuming IPL's transmission-related obligations under those agreements and IPL continuing to perform

non-transmission functions under those agreements. Applicants state that IPL and ITC Midwest intend that IPL's transmission-related obligations under the agreements will be transferred to ITC Midwest without any material change to those agreements and the parties' rights and responsibilities under them. There thus is no need for the Commission to stipulate that none of the transferred agreements will be substantively affected by the transfer or to require IPL to obtain consent to the transfer from the counterparties.

140. In response to the concerns Dairyland expresses regarding the Grandfathered Agreements, Applicants state that those contracts will remain in place without material change, with ITC Midwest assuming IPL's transmission-related obligations under those agreements and IPL continuing to perform non-transmission functions.

141. Applicants have provided specific assurances that address the concerns raised by CIPCO, Corn Belt and Dairyland. We will accept Applicants' assurances that the rights and entitlements of CIPCO, Corn Belt and Dairyland will not be affected by the proposed transaction. Also, we note generally that approval of a transaction under section 203 does not free the parties from any legal obligations they have.⁸² Schedule 5.3(d) lists contracts whose transfer requires the consent of the counterparties.

6. Additional Public Offering

a. Applicants' Request

142. Applicants state that ITC Holdings anticipates financing the Transaction in part through a sale of its common stock. They explain that this equity sale will be subject to the existing limitations on the acquisition of ITC Holdings' equity securities by any market participant specified in the ITC Holdings Articles of Incorporation and previously approved by the Commission in the *IPO Order*. Applicants state that when the Commission authorized an indirect change of control resulting from the initial public offering of ITC Holdings common stock, it also authorized additional public offerings of ITC Holdings stock for a period of two years, or until May 5, 2007. ITC Holdings requests that the Commission extend its authority to make public offerings of its common stock for an additional two years for the purpose of financing the Transaction. Applicants state in this connection that ITC Holdings' Amended and Restated Articles of Incorporation assures the independence of ITC Holdings and its subsidiaries from market participants.⁸³

⁸² See, e.g., *First Energy Corp.*, 112 FERC ¶ 61,243, at P 24 (2005).

⁸³ Specifically, Applicants state that Article VIII of this document provides in clause (d) that if a market participant or a group containing a market participant acquires five percent or more of any class of ITC Holdings stock, no market participant or group

(continued...)

b. Commission Determination

143. Applicants somewhat mischaracterize our actions in the *IPO Order*, in that we did not authorize the issuance of securities there. Rather, in the *IPO Order* the Commission (i) approved a disposition of jurisdictional facilities associated with a public offering of ITC Holdings' common stock and (ii) found, based on prior cases and the broad base of stockholders expected from the public offerings, as well as certain restrictions proposed in that case by the applicants,⁸⁴ that International Transmission would remain independent. The Commission also determined that ITC Holdings and International Transmission would not be required to make further filings under section 203 of the FPA in connection with additional offerings of ITC Holdings common stock for a period of two years, or until May 5, 2007.

144. We will grant Applicants' request that ITC Holdings be permitted to make additional offerings of its common stock without making further filings under section 203 for two years from the date of this order, provided that all the conditions and restrictions specified in the *IPO Order* are met. As in the *IPO Order*, we conclude that those conditions and restrictions, including the reporting requirements specified in the *IPO Order*, will prevent market participants from being able to influence ITC Holdings' subsidiaries and thus undermine their independence.

D. Midwest Muni Group Complaint

1. Complaint and Responsive Pleadings

145. Midwest Muni Group filed a complaint under section 206, seeking to lower from 12.38 percent to 9.36 percent the ROE previously approved for all Midwest ISO TOs –

containing a market participant may vote, give consent in respect of, or direct or control five percent or more of any class of ITC Holdings stock. In addition, the ITC Holdings Board of Directors is empowered to redeem shares in such cases to protect the company's independence from a market participant.

⁸⁴ Applicants referred to the restrictions and Board powers described in n. 86 above. Applicants also stated that while ITC Holdings would have no practical way of knowing if a market participant acquires a de minimis amount of its stock, Securities and Exchange Commission (SEC) notice requirements would allow ITC Holdings to identify stockholders and groups of stockholders that beneficially own five percent or more of ITC Holdings stock. *IPO Order*, 111 FERC ¶ 61,149 at P 15. The Commission required that the applicants inform it within 10 days if they receive notice from the SEC that the five percent level had been reached or exceeded by a market participant or a group that includes a market participant. *Id.* at P 25.

but only as it applies to the pricing zone in which IPL is the transmission owner. Midwest Muni Group also asks to consolidate the complaint with the section 203 and 205 proceedings.

146. Midwest Muni Group argues that the cost-based ROE for IPL's transmission facilities, and thus the starting point for any incentive ROE that may be considered in these dockets, is below 12.38 percent. Midwest Muni Group supports its complaint with a DCF analysis of the Midwest ISO TO proxy group that was filed with Municipal Coalition's protest to ITC Midwest's section 203 application.⁸⁵ That study produced a midpoint ROE of 9.36 percent. Midwest Muni Group argues that IPL's ROE should be set at the midpoint or lower end of the range of implied cost of equity data points produced by the study because IPL has "neglected its transmission system."⁸⁶

147. Midwest Muni Group simultaneously filed an offer of settlement under which the ROE applicable to the facilities in the IPL zone would remain 12.38 percent, even if ITC Midwest purchases the facilities. The 12.38 percent ROE would include all ROE incentives and would become a conditionally-penetrable ceiling on the ROE for the IPL zone for 5 years following acceptance of the settlement, i.e., the ROE could go higher, but only on strictly cost-based grounds. Specifically, the ceiling could be penetrated only by establishing that the actual cost of equity capital invested in transmission by IPL or its successor exceeds 12.38 percent. Midwest Muni Group would withdraw its complaint if the offer of settlement is accepted.

148. Jo-Carroll filed comments that support consolidation and the offer of settlement. Jo-Carroll states that the offer of settlement is a reasonable resolution of the issues presented in this proceeding and in the section 203 and 205 proceedings.

149. IPL, ITC Midwest, and the Midwest ISO request that the Commission dismiss the complaint. IPL and the Midwest ISO argue that the complaint is a collateral attack on the Commission orders approving the 12.38 percent ROE in 2002 and that Midwest Muni Group should be estopped from relitigating the issue.

150. IPL and ITC Midwest argue that the complaint should not be consolidated with the proceedings under sections 203 and 205. Those proceedings concern the appropriate ROE for ITC Midwest, not IPL, and ITC Midwest's ROE can be resolved independently from IPL's ROE. The Midwest ISO expresses concern about the chilling effect the complaint may have on the ongoing efforts by the Commission and Midwest ISO to encourage transmission investment in the region. The Midwest ISO points out that

⁸⁵ Midwest Muni Group is a member of Municipal Coalition.

⁸⁶ Complaint at 9.

region-wide ROE determinations for transmission-owning members of RTOs were meant to promote certainty by providing closer integration and consistency in RTO planning and expansion efforts. The Midwest ISO TOs caution that any Commission decision on the complaint should not impact the ROEs in place for other pricing zones within the Midwest ISO. They state that this proceeding should not reopen the regionally applicable 2.38 percent base ROE that was determined after extensive administrative litigation.

2. Commission Determination

151. We will deny the relief requested in the complaint. We believe the complainants have not met their burden of proof that the ROE approved for TOs in the Midwest ISO is not just and reasonable. We have set a 12.38 percent ROE for ITC Midwest, which coincides with the central element of the offer of settlement referenced in the complaint. We will not address the further issue of whether there should be some moratorium on rate increases as discussed in the unilateral offer of settlement. Depending on the circumstances, such action could be overly restrictive and prejudicial to IPL or ITC Midwest's rights under the FPA, and it would be premature to address the reasonableness of any increase in ROE that IPL or ITC Midwest may propose in the future. Any such increase would have to be supported and approved by the Commission, and Midwest Muni Group may raise its concerns about the reasonableness of such a proposal if and when it is made.

The Commission orders:

(A) The proposed Transaction is hereby authorized under FPA section 203 as discussed in the body of this order.

(B) Applicants' request for approval of Transmission Service Rates and Certain Jurisdictional Agreements and Approval of Prospective Application of Attachment O is approved, subject to the modifications and conditions discussed in the body of this order, including the required compliance filings discussed in the body of this order.

(C) Applicants' request that ITC Holdings be permitted to make additional offerings of its common stock without making further filings under section 203 for a period of two years from the date of this order, provided all the conditions and restrictions specified in this connection in the *IPO Order* are met, is approved.

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

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

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

(G) Applicants shall account for the Transaction in accordance with Electric Plant Instruction No. 5 and Account 102, Electric Plant Purchased or Sold, of the Uniform System of Accounts. The final accounting must be submitted for approval within six months of the date the Transaction is consummated, and the accounting submission shall provide all the accounting entries related to the transfer along with narrative explanations describing the basis for the entries.

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

(I) Applicants must inform the Commission of any change in circumstances that would reflect a departure from the facts the Commission relied upon in authorizing the transaction.

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

(K) The relief requested in Midwest Muni Group's complaint is hereby denied.

By the Commission. Commissioner Kelly concurring in part with a separate statement attached.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ITC Holdings Corp.	Docket Nos. EC07-89-000
ITC Midwest LLC	EC07-89-001
Interstate Power and Light Company	ER07-887-000
Midwest Independent Transmission System Operator, Inc.	ER07-887-001

Midwest Municipal Transmission Group v. Interstate Power and Light Company and Midwest Independent Transmission System Operator, Inc.	Docket No. EL07-85-000
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(Issued December 3, 2007)

KELLY, Commissioner, *concurrence in part*:

This order addresses, among other things, ITC Midwest's proposed return on equity (ROE), which is based on the 12.38 percent ROE currently approved for use by all Midwest ISO transmission owners, with a 100 basis point incentive for independent ownership and a 50 basis point incentive for regional transmission organization (RTO) membership. While I agree with the finding that ITC Midwest has not demonstrated that a 13.88 percent ROE is within the zone of reasonableness, I note that the Commission has in other proceedings approved the incentives requested by Midwest ITC.¹ I would have supported granting the incentives for independent ownership and RTO membership if Midwest ITC had demonstrated that the resulting ROE fell within the zone of reasonableness. For this reason, I concur with the order.

Suedeem G. Kelly

¹ *ITC Holdings Corp.*, 102 FERC ¶ 61,182, *reh'g denied*, 104 FERC ¶ 61,033 (2003); *Duquesne Light Co.*, 118 FERC ¶ 61,087 (2007).