

102 FERC ¶ 61, 182  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
William L. Massey, and Nora Mead Brownell.

ITC Holdings Corp.  
ITC Holdings Limited Partnership  
International Transmission Co.  
DTE Energy Co.  
Detroit Edison Co.

Docket Nos. EC03-40-000  
ER03-343-000

ORDER AUTHORIZING DISPOSITION OF JURISDICTIONAL FACILITIES,  
ACCEPTING FOR FILING PROPOSED AGREEMENTS, REQUIRING  
COMPLIANCE FILING, AND ACCEPTING IN PART AND REJECTING IN PART  
PROPOSED TRANSMISSION RATES

(Issued February 20, 2003)

1. In this order, we authorize the disposition of jurisdictional facilities pursuant to section 203 of the Federal Power Act (FPA). We will also accept in part and reject in part, pursuant to section 205 of the FPA, International Transmission Company's (International Transmission) proposed transmission rates, and accept for filing certain operating and interconnection agreements between International Transmission and Detroit Edison Company (Detroit Edison), to be effective on the closing date of the proposed transaction. This order benefits customers because the transfer of transmission facilities to an independent entity is one of the most effective means of separating transmission interests from generation interests and achieving independence through a for-profit transmission company. In addition, our partial approval of the proposed transmission rates and certain agreements between International Transmission and Detroit Edison should benefit customers by enhancing competition and reliability by encouraging new investment in infrastructure.

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## I. Background

2. This filing results from the Commission's interrelated orders issued on December 20, 2001 to move forward the process of establishing an optimally sized RTO in the Midwest. In Docket No. EC01-137-000,<sup>1</sup> the Commission preliminarily approved, under section 203 of the FPA, a joint application by DTE Energy Company (DTE Energy) and its wholly-owned subsidiary, International Transmission Company (International Transmission) to dispose of International Transmission's jurisdictional facilities to an as yet undetermined, unaffiliated third party that was not a market participant as defined in 18 C.F.R. 35.34 (b)(2) and was not subject to any level of active or passive ownership interests by a market participant.<sup>2</sup> The Commission required an amended filing once International Transmission's purchaser was determined. The Commission reasoned that before it could determine whether to give final approval to the proposed transaction, it must have all the relevant facts, particularly the identity of the purchaser, in order to ensure that the buyer is not a market participant and that the proposed transaction is consistent with the public interest.

3. In addition, in Docket Nos. ER01-3000-001, *et al.*, the Commission accepted an Appendix I Agreement with the Midwest ISO (ITC-MISO Agreement), as modified by the Supplemental Agreement and other modifications,<sup>3</sup> under which International Transmission would join the Midwest Independent Transmission System Operator (Midwest ISO) as an independent transmission company and would share certain RTO functions with the Midwest ISO. The Supplemental Agreement clarified that specific provisions of the ITC-MISO Agreement<sup>4</sup> should only become effective when

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<sup>1</sup>DTE Energy Co. and International Transmission Co., 97 FERC ¶ 61,330 (2001) (DTE).

<sup>2</sup>DTE Board Resolutions, Attachment 1 (Docket No. EC01-137-000 Application).

<sup>3</sup>International Transmission Co., 97 FERC ¶ 61,328 (2001) (ITC).

<sup>4</sup>The following Special Provisions would assign certain rights to International Transmission: Section 4.2.2. (certain system security authority granted to International Transmission); Section 5 (billing service for the International Transmission OATT); Sections 7.1 and 7.2 (International Transmission's authority to establish transmission facility ratings and operating procedures, and to set maintenance and outage schedules); Section 8.2 (future development of a coordinated planning process between International  
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International Transmission is divested to an entity not affiliated with a market participant. The Commission deferred any final decision regarding the assignment of responsibilities under the ITC-MISO Agreement until International Transmission was divested. In the interim, the Commission found that the Supplemental Agreement would provide adequate safeguards to facilitate International Transmission's participation in the Midwest ISO, and that the Special Provisions would not be in effect during this interim period. In addition, pursuant to section 203 of the FPA, the Commission approved the transfer of operational control of International Transmission's facilities to the Midwest ISO (thereby allowing an RTO to operate International Transmission's facilities in conjunction with other transmission owners' facilities in the Midwest ISO).

## **II. Instant Filing**

4. On December 24, 2002, ITC Holdings Corp. (ITC Holdings), ITC Holdings Limited Partnership (ITC Holdings LP), International Transmission, DTE Energy, and Detroit Edison (collectively, Applicants), filed a joint application pursuant to section 203 of the FPA for Commission authorization for the disposition of International Transmission's jurisdictional facilities to ITC Holdings through the sale of International Transmission's stock to ITC Holdings, which they describe as an independent, unaffiliated purchaser. The jurisdictional assets involved include all physical transmission facilities owned by International Transmission, as well as all contracts, related books of account, and records.

5. Applicants also submit for filing proposed transmission rates for International Transmission, pursuant to section 205 of the FPA, to become effective upon closing of the proposed disposition, without modification, suspension or hearing and certain operating and interconnection agreements between International Transmission and Detroit Edison.

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<sup>4</sup>(...continued)

Transmission and the Midwest ISO, subject to Commission approval); Section 9 (International Transmission's authority to provide generator interconnection service, subject to Commission approval); Section 11.3 and its subsections (International Transmission's authority to establish the International Transmission OATT administered by the Midwest ISO) and Section 11.4 (International Transmission's authority to set zonal rates).

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**A. Description of Applicants**

6. ITC Holdings LP will be a Michigan limited partnership formed to act as a controlling shareholder of ITC Holdings. ITC Holdings LP will have one general partner, Ironhill Transmission LLC (Ironhill), to be formed as a limited liability company. Ironhill will manage ITC Holdings' business affairs. According to Applicants, ITC Holdings LP will not be an affiliate of any entity that owns, operates or controls any generating facilities, or that sells or brokers electricity. The limited partners in ITC Holdings LP are certain investment funds that are affiliated with Kohlberg Kravis Roberts & Co. (KKR) and Trimaran Capital Partners, LLC (Trimaran). Those limited partners will have consent rights regarding certain extraordinary and other transactions that might materially affect their investment, but they will not be involved in the daily management of the business.

7. ITC Holdings will be 95 percent owned by ITC Holdings LP. Management and employees of International Transmission and ITC Holdings will own approximately five percent of ITC Holdings.

8. DTE Energy, a public utility holding company exempt from registration under section 3(a)(1) of the Public Utility Holding Company Act of 1935 (PUHCA),<sup>5</sup> owns interests in subsidiaries that engage in generation, transmission or distribution of electric energy or related energy services in North America. DTE Energy has two principal public utility subsidiaries, Detroit Edison and International Transmission. Detroit Edison is engaged in the generation and retail distribution of electric energy in the State of Michigan. Detroit Edison also sells electric energy at wholesale at cost-based rates and is authorized to sell power at wholesale at market-based rates.<sup>6</sup>

9. International Transmission, a wholly-owned subsidiary of DTE Energy, owns substantially all of the transmission assets formerly owned by Detroit Edison.<sup>7</sup> International Transmission has transferred operational control over its jurisdictional

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<sup>5</sup>15 U.S.C. § 79c(a)(1) (2000).

<sup>6</sup>Detroit Edison Co., 80 FERC ¶ 61,348 (1997).

<sup>7</sup>See DTE Energy Co., et al., 91 FERC ¶ 61,317 (2000) (Commission authorized the disposition of substantially all of Detroit Edison's integrated transmission facilities with a voltage rating of 120 kV and above to International Transmission).

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transmission facilities to the Midwest ISO.<sup>8</sup> International Transmission's facilities are directly interconnected with those of Michigan Electric Transmission Company (METC), a wholly-owned subsidiary of CMS Energy Corporation (CMS), and those of American Transmission Systems, Inc., a wholly-owned subsidiary of First Energy Corporation. International Transmission and METC jointly operate their interconnected transmission systems, which comprise substantially all of the Michigan transmission grid, as a single control area.

**B. Proposed Disposition of Facilities**

10. Applicants seek authorization for DTE Energy to sell all of the outstanding shares of common stock of International Transmission to ITC Holdings, an independent, unaffiliated third party that was selected as the winning bidder in a competitive bidding process. Applicants state that the divestiture would result in International Transmission's independence from all market participants, including DTE Energy and its affiliates. International Transmission states that it would be managed by an independent management team with no financial ties with market participants, including DTE Energy and its affiliates. Employees who work for International Transmission will have no economic or financial stake in DTE Energy or any other market participant.<sup>9</sup> The Stock Purchase Agreement (Purchase Agreement) between DTE Energy and ITC Holdings, executed on December 3, 2002, establishes the terms and conditions under which DTE Energy will sell to ITC Holdings all the outstanding shares of common stock of International Transmission.<sup>10</sup>

11. Applicants explain that upon the closing of the transaction, International Transmission would acquire title to Detroit Edison's real property interests relating to the transmission system, subject only to Detroit Edison's retention of certain rights regarding non-transmission uses of the properties, but the use of real property by International Transmission for transmission uses will prevail over these non-transmission users.

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<sup>8</sup>See ITC.

<sup>9</sup>See Application, Testimony of Joseph L. Welch, Attachment 8.

<sup>10</sup>Section 1.2 of the Purchase Agreement states that the base purchase price is \$610,000,000, and subject to certain adjustments. Applicants expect that the transaction will occur during the first quarter of 2003, as required by the Purchase Agreement, and seek expedited Commission approval of their application by no later than February 20, 2003.

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Further, Applicants state that International Transmission would not own, operate or control any generating facilities and would procure any necessary generation-based ancillary services from third-party suppliers, including Detroit Edison.

12. Applicants also emphasize that International Transmission would continue as a member of the Midwest ISO, in accordance with ITC-MISO Agreement approved by the Commission. Applicants state that there will be no effect on the terms or conditions of transmission services that are currently provided to customers over the International Transmission system under the Midwest ISO OATT and Midwest ISO JOATT. In addition, Applicants assert that they will use their best efforts to facilitate the transfer to the Midwest ISO of International Transmission's operational responsibility and control of the phase angle regulators (PARs) that comprise part of the facilities owned by International Transmission at the Michigan-Ontario, Canada international border.

13. Applicants state that after the divestiture, Detroit Edison would continue to be a transmission customer of the Midwest ISO, and would provide local distribution service subject to regulation by the Michigan Commission. According to Applicants, Detroit Edison would provide distribution service to wholesale customers in accordance with the Commission's requirements, and the Commission would regulate wholesale sales made by Detroit Edison and affiliates. Applicants pledge that Detroit Edison would continue to honor its existing obligations under grandfathered agreements, and that Detroit Edison would not provide transmission service under such agreements, but will procure necessary transmission to support continued bundled service to customers under such agreements. Applicants state that Detroit Edison would continue to own and operate its generating facilities to be interconnected with the International Transmission system at multiple locations. Further, Applicants note that the Michigan Public Service Commission has granted the necessary state approvals relating to the proposed transaction.

14. Applicants also seek approval of a pre-sale merger, at DTE Energy's option, of International Transmission with and into a Michigan limited liability company (LLC)<sup>11</sup> and the post-sale merger of the LLC with and into a Michigan corporation. Applicants state that this internal corporate restructuring is necessary to effectuate the proposed transaction in the most efficient and financially beneficial manner, but will not affect their section 203 application, and that after closing, International Transmission will revert back to its original corporate form under new, independent ownership. Upon

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<sup>11</sup>See Purchase Agreement, section 5.20.

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completion of the reorganization, ITC Holdings would wholly own, directly or indirectly, the surviving corporate organization.

**C. Related Contracts and Agreements**<sup>12</sup>

**1. Service Level Agreements**

15. International Transmission and Detroit Edison would enter into two service agreements that would govern the provision of construction and maintenance, engineering, system operations and corporate administration services by Detroit Edison to International Transmission.

**2. Generator Interconnection and Operation Agreements**

16. These agreements would govern the direct interconnection of the generating facilities of Detroit Edison and the transmission system of International Transmission. Applicants state that pursuant to the GIA, Detroit Edison will continue to own and operate its generating facilities.

**3. Master Operating Agreement (MOA)**

17. The MOA between Detroit Edison and International Transmission would govern certain control area coordination arrangements between Detroit Edison and International Transmission.

**4. Coordination and Interconnection Agreement**

18. This agreement would govern the coordinated operation and interconnection of the

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<sup>12</sup>In addition, the Purchase Agreement provides that the Master Services Agreement dated December 22, 2000 between Detroit Edison and International Transmission, and the Cash Management Services and Working Capital Load Agreement, dated July 31, 2001, between International Transmission and DTE Energy would terminate without any further obligations thereunder.

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Detroit Edison distribution system and the transmission system of International Transmission.<sup>13</sup>

### **III. Notices and Responsive Pleadings**

19. Notice of the application was published in the Federal Register, 68 Fed Reg 1057 (2003), with interventions and protests due on or before January 14, 2003. Timely motions to intervene raising no substantive issues were filed by the City of Wyandotte, Michigan; Consumers Energy Co.; Nordic Marketing, LLC; and SE Michigan Systems. The Michigan Electric Transmission Co., LLC (METC) and the Wolverine Power Supply Cooperative, Inc. (Wolverine) filed timely motions to intervene and comments. The State of Michigan and the Michigan Public Service Commission jointly filed a timely notice of intervention and comments. Dearborn Industrial Generation, LLC (DIG) and the Association of Businesses Advocating Tariff Equity (ABATE) filed timely motions to intervene and protests. On January 17, 2003, the Michigan Public Power Agency and Michigan South Central Power Agency filed a late motion to intervene.

20. On January 23, 2003, Commission staff requested additional information from Applicants. On January 28, 2003, Applicants submitted supplemental information in response to the staff data request.

21. On January 29, 2003, Applicants filed an answer to the protests filed in this proceeding. On January 30, 2003, the Ontario Independent Electricity Market Operator (Ontario) filed a late motion to intervene and protest. On February 3, 2003, Applicants filed an answer to Ontario's protest.

### **IV. Discussion**

#### **A. Procedural Matters**

22. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, the notices of intervention and the timely, unopposed motions to intervene filed by METC, DIG, ABATE and Wolverine, make these entities parties to this proceeding. Given the early state of the proceedings, the interests of the entities, and the absence of undue delay or prejudice, we find good cause to grant the untimely, unopposed motion to intervene of

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<sup>13</sup>See Application, Vol. II, Exhibit F.

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the Michigan Public Power Agency and Michigan South Central Power Agency, and Ontario Independent Electricity Market Operator.

23. Rule 213 of our Rules of Practice and Procedure prohibits answers to protests, unless otherwise ordered by the decisional authority. We will accept Applicants' answers to the extent that they aid us in our decisionmaking.

24. Ontario requests that as a condition to the divestiture, the Commission: (1) require International Transmission to unbundle an interconnection agreement with Detroit Edison and Consumers Power Company (collectively, Michigan companies) because of the Michigan Companies' lack of cooperation regarding the services and responsibilities under the contract post-divestiture; and (2) require the phase shifting transformer located at the interface of the border to be operated in accordance with the currently effective Department of Energy's (DOE) Presidential Permit PP-230-2 in order to ensure the coordinated operation and reliability of cross-border power flows affecting both Canada and the United States. In their answer to Ontario, Applicants state that Ontario's requests are beyond the scope of this proceeding.

25. We find that Ontario's claims are beyond the scope of this proceeding, and therefore, we will reject Ontario's protest. Our approval of the divestiture does not affect other necessary approvals, such as obtaining consent from any party to a contract. Further, as compliance with a DOE Presidential Permit is within DOE's jurisdiction, this issue is not before the Commission.

## **B. Independence**

26. In Order No. 2000, the Commission recognized that independence was critical to an RTO's non-discriminatory operation of the electric grid.<sup>14</sup> The Commission reaffirmed that "the principle of independence is the bedrock upon which the ISO must be built" and that "this principle must apply to all RTOs, transcos or variants of the

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<sup>14</sup>See Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,089 at 31,064 (1999), order on reh'g, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,092 (2000), aff'd sub nom. Public Utility District No. 1 Snohomish County Washington, et al. v. FERC, Nos. 00-1174, et al. (D.C. Cir., Dec. 11, 2001).

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two."<sup>15</sup> The Commission set forth independence as critical to an RTO's non-discriminatory operation of the electric grid and reaffirmed that "[a]n RTO needs to be independent both in reality and perception."<sup>16</sup>

27. In applying Order No. 2000's independence principle to independent transmission

companies, the Commission considers the effect of ownership interests on the independent transmission company's independence, *i.e.*, whether Applicants' proposed ownership structure involves "market participants."<sup>17</sup> In Order No. 2000, as amended by Order No. 2000-A, the Commission defined a market participant as: (i) any entity that, either directly or through an affiliate,<sup>18</sup> sells or brokers electric energy, or provides ancillary to the RTO, unless the Commission finds that the entity does not have economic or commercial interests that would be significantly affected by the Regional Transmission Organization's actions or decisions; and (ii) any other entity that the Commission finds has economic or commercial interests that could be significantly affected by the RTO's actions or decisions.<sup>19</sup> Under Order No. 2000, a market participant can have active ownership interests in an RTO of up to five percent for a transition period not to exceed five years, and can hold passive ownership interests in an RTO, subject to review by the Commission on a case-by-case basis.<sup>20</sup>

28. The Commission has granted certain rate treatments for transmission owners that have either met or exceeded the independence standard in Order No. 2000 on a case-by-case basis. For example, in Trans-Elect, the Commission approved rate treatments

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<sup>15</sup>Id. at 31,061.

<sup>16</sup>Id.

<sup>17</sup>Id.

<sup>18</sup>Order No. 2000 defines "affiliate" according to section 2(a)(11) of PUHCA, which determines affiliation by, inter alia, a five percent voting interest or by a Securities and Exchange Commission determination that because of the companies' relationship, there is liable to be a lack of arms' length bargaining. Id. at 31,061.

<sup>19</sup>Id., see also Order No. 2000-A at 31,361-64.

<sup>20</sup>Order No. 2000 at 31,061.

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similar to those requested in the present case in consideration of the benefits that would accrue to customers as a result of the independence created by the transaction.<sup>21</sup> The Commission is continuing to explore the independence standard for incentive rate treatment in the context of independent transmission companies.<sup>22</sup>

### 1. Ownership Structure of International Transmission

29. In support of their proposal, Applicants contend that the divestiture of International Transmission to ITC Holdings LP would result in International Transmission operating as a completely independent, for-profit transmission company under the Midwest ISO umbrella, *i.e.*, International Transmission would be independent of all market participants. Applicants further state that they do not propose to undertake certain RTO functions relating to coordinated planning, maintenance and tariffs set forth in the Special Provisions of the supplemental agreement to the ITC-MISO Agreement.<sup>23</sup>

30. Post-divestiture, ITC Holdings LP would own and, through its majority ownership of stock, control ITC Holdings, which would own and manage International Transmission. IronHill, the general partner in ITC Holdings LP, would manage the business affairs of ITC Holdings. In turn, Ironhill would be owned by a single

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<sup>21</sup>Trans-Elect, Inc., 98 FERC ¶ 61,142, order on reh'g, 98 FERC ¶ 61,368 (2002) (Trans-Elect).

<sup>22</sup>See Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid (issued on January 15, 2003) (Docket No. PL03-1-000). The Commission recently proposed that an independent transmission company must be fully independent, *i.e.*, no active or passive ownership interests in the independent transmission company by market participants, in order to qualify for either the allowance tied to deferred taxes approved in Trans-Elect or an ROE-based lump sum payment incentive for independent ownership. We are informed, but not limited by, the proposed pricing policy as it is pending.

<sup>23</sup>Applicants had previously requested to take on these functions in Docket No. ER01-3000-001, et al., but the Commission stated that it would rule on this request after a Winning Bidder was selected. See also note 5. We note that in the instant filing, International Transmission does not now propose to adopt any of the functions contained in the Special Provisions, and that it will submit a separate, more detailed filing when it intends to implement any of the "Special Provisions" in the ITC-MISO Agreement. See Application, Exhibit IT-100 at 15-16.

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individual, Mr. Lewis M. Eisenberg. Applicants state that Mr. Eisenberg is not a market participant and does not have a financial interest in any market participant.

31. The limited partners in ITC Holdings LP are investment funds affiliated with Trimaran (an asset management company) and KKR (a private investment firm). Applicants contend: (1) that neither limited partner is a market participant, and; (2) that given the limited partners' lack of voting control over and participation in the day-to-day operations of International Transmission, neither limited partner should be deemed an affiliate (as defined under PUHCA) of International Transmission. According to Applicants, the limited partners would have consent rights regarding certain extraordinary and other transactions that might materially affect their investment, but would not have a role in the day-to-day management and operation of the business.<sup>24</sup>

32. Trimaran is a limited partner in a partnership that wholly owns the corporate parent of Texas-New Mexico Power Company.<sup>25</sup> According to Applicants, the KKR funds that would be limited partners in ITC Holdings LP (referred to here as KKR Millenium Fund) do not have an investment interest in any market participant. However, another KKR investment fund, the KKR 1996 Fund, holds voting preferred securities (through an affiliate, Dayton Ventures) equal to 4.9 percent of total voting rights in DPL, Inc. (DPL). DPL is a holding company that owns Dayton Power & Light Company (Dayton Power), which sells energy. Dayton Ventures' voting control over DPL is limited to certain approval rights to protect its investment in DPL, including actions that would cause it to own more than 4.9 percent of DPL's voting securities or subject it to PUHCA regulation. Dayton Ventures also holds warrants to purchase common shares of DPL equal to 25 percent of total DPL common shares,<sup>26</sup> and has the right to appoint one DPL director. Currently, two KKR executives serve on DPL's 11-member board.

## **2. Comments and Applicants' Answer**

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<sup>24</sup>Applicants state that the limited partners' role would be the same as that of GE Capital Services Structured Finance Group in Michigan Transco Holdings, LP. See Trans-Elect.

<sup>25</sup>Texas-New Mexico Power Company operates only in the ERCOT portion of Texas and in New Mexico, which is part of the Western Interconnection.

<sup>26</sup>Applicants state that no warrants have been exercised and that KKR and its affiliates do not own any common shares of DPL.

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33. ABATE suggests that International Transmission may not be truly independent. ABATE argues that KKR should be considered a market participant due to its involvement with Dayton Power, its ability to exercise warrants to buy common shares of DPL, and its representation on DPL's board of directors.

34. In their answer, Applicants continue to assert that neither KKR nor KKR Millenium Fund is a market participant. They state that neither fund sells or brokers energy and that KKR Millenium Fund does not have any investment interest of any type in a market participant. In addition, Applicants point out that KKR Millenium Fund, not KKR or the KKR 1996 Fund itself, would be the limited partner in ITC Holdings LP and that the manager of KKR Millenium Fund has an independent fiduciary duty to make investments for the benefit of its investors, without regard to investments held by any other KKR fund, including the KKR 1996 Fund. Applicants further assert that KKR has no direct or indirect economic or commercial interest that would make it a market participant as defined in Order No. 2000 because KKR 1996 Fund's limited interest in DPL does not make KKR 1996 Fund, or KKR Millenium Fund or KKR itself, a market participant.

35. Applicants state that KKR 1996 Fund is the only fund that has an interest (but not any common equity) in a market participant. They contend that KKR 1996 Fund's limited investment interest in DPL does not make either KKR or KKR 1996 Fund an affiliate of DPL, as the voting interest is below the five percent level set forth for an affiliate under PUHCA. Also, Applicants state that the warrants to purchase DPL common shares do not make KKR a market participant, as KKR has not exercised its warrants, does not have voting power over DPL and is not involved in the day-to-day operations of DPL. Applicants contend that the Securities and Exchange Commission (SEC) has held that the existence of potential voting rights that are not actually exercised (such as the KKR warrants) are not voting securities.

36. Applicants contend that neither KKR nor KKR Millenium Fund will be an "affiliate," as defined under PUHCA, of International Transmission, because neither will have voting power over or participate in the day-to-day operations of International Transmission. Applicants note that as a limited partner, KKR Millenium Fund will have a role no greater than that of the limited partners in Michigan Transco Holdings, LP.

### **3. Commission Response**

37. At issue is whether Applicants' proposed transaction raises any independence

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concerns that would impact our ruling on their request for certain rate treatments involving ADIT and ROE Basis Points.<sup>27</sup> Accordingly, the Commission will review Applicants' proposed ownership and governance structure in the context of Applicants' rate treatment proposal.<sup>28</sup>

38. As noted above, ABATE contends that the independence of International Transmission is threatened in a number of ways, principally by KKR's indirect market interests and certain service agreements. We will examine all facets of Applicants' proposal as they relate to International Transmission's independence.

**a. Ownership and Governance Structure**

39. We begin with the role of the active participants in the ownership and governance structure of International Transmission. Here, although the limited partners would hold nearly all of the ownership interests in the partnership, Mr. Eisenberg would wholly own Ironhill, the general partner that would control the partnership (except for certain limited rights held by the limited partners) and manage the business affairs of ITC Holdings. According to Applicants, Mr. Eisenberg has no financial interest in any market participant, and ITC Holdings LP and Ironhill are investment vehicles that would not have employees and management. In addition, Applicants submit International Transmission would be managed by an independent management team that would have severed all financial ties with market participants, and that all employees of International Transmission would have no economic or financial stake in any market participant, including former Detroit Edison employees that transfer to International Transmission. Applicants set forth several steps to ensure that this goal of operational independence is met.<sup>29</sup> They further state that all officers of International Transmission will have their income taxes prepared by an independent auditing firm to ensure compliance with the provisions outlined.

40. The steps proposed by Applicants would ensure that management and employees

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<sup>27</sup>With regard to the independence requirements for International Transmission to assume any RTO functions, these are the same independence requirements in Order No. 2000.

<sup>28</sup>See subsequent discussion on rate treatment.

<sup>29</sup>Application, Exhibit No. IT-100 at 18-19.

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of ITC Holdings and International Transmission have no financial or economic stake in any market participant, including DTE Energy, and thus achieve operational independence for International Transmission. As none of the active participants in the proposed ownership and governance structure would have any economic or financial ties to market participants (except through diversified funds that are not concentrated in the energy sector) we find that under Applicants' proposal, International Transmission will be independent of market participants, insofar as active ownership or participation is concerned.

41. With respect to the role of limited partners in the operation of International Transmission, we find that their limited participation would not affect International Transmission's independent operation. Applicants assert that none of the limited partners will be an "affiliate" of ITC Holdings because they will not have voting power over, or participate in the day-to-day operations of ITC Holdings and International Transmission. The limited partners "will have consent rights regarding certain extraordinary and other transactions that might materially affect their investment, such that their role in the partnership is primarily limited to providing the equity investment."<sup>30</sup> In some instances, a simple majority of the limited partners' interests is controlling; in other instances, three-fourths of the limited partners' interests is required.<sup>31</sup> Applicants state that the limited partners' role is similar to that in GE Capital Services Structured Finance Group, Inc., in Michigan Transco Holdings, Limited Partnership.

42. To more fully assess whether the limited partners have the ability to affect International Transmission's operation, we have also reviewed the ITC Holdings LP partnership agreement and find that the agreement does not trigger such concerns. The consent rights mainly apply to merger, consolidation and reorganization actions, as well as actions that would make any limited partner become subject to PUHCA regulation. These consent rights are similar to the transco arrangements that we previously approved.<sup>32</sup> We note that a majority-in-interest of the limited partners is necessary in order for the partnership or its subsidiaries to incur debt greater than \$10 million in excess of the current operating and business plan or to adopt any budget that exceeds the

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<sup>30</sup>Application, Exhibit D at 2.

<sup>31</sup>KKR Millenium Fund and a sister KKR fund will hold 69.67 percent of the partnership.

<sup>32</sup>See, e.g., *Arizona Public Service Co., et al.*, 101 FERC ¶ 61,033 at 61,109-110 (2002) (citing *GridSouth*, 94 FERC ¶ 61,273 at 61,986 (2001)).

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prior year's budget by more than 15 percent. Such provisions, however, are merely intended to protect the limited partner's investment in the partnership (by allowing it to vote on matters that could significantly affect its financial interests), and do not provide a limited partner with the ability to direct the day-to-day operations of the partnership. That is done by the general partner.

43. Turning to KKR's involvement with Dayton Power,<sup>33</sup> we find that, based on the following reasons, KKR is not a market participant. Dayton Venture's voting interests in DPL are below the five percent threshold that would make KKR an affiliate of DPL under our regulations implementing Order No. 2000.<sup>34</sup> In addition, there is no evidence in this record that a decision of the Midwest ISO or International Transmission would significantly affect KKR as a result of its financial interest in DPL<sup>35</sup> (i.e., through its current level of ownership of DPL preferred stock and the outstanding warrants that provide KKR with an option to purchase additional shares of DPL). Consequently, we find that, based on KKR's current financial holdings and its voting interests in DPL, KKR is not a market participant under the definition of market participant set forth in section 35.34 of our regulations.<sup>36</sup> Therefore, in these circumstances, the Commission will grant Applicants' request for incentive rate treatment, as discussed more fully below. However, if KKR exercises the warrants such that its voting interest exceeds five percent, Applicants will not be permitted to continue to receive the rate treatment permitted below.

44. As discussed above, we have carefully considered whether KKR's voting interest

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<sup>33</sup>As International Transmission would be participating in the Midwest ISO, we find that Trimaran (which is affiliated through a limited partnership with Texas-New Mexico Power Company, a seller of electric energy that is located in the Western Interconnection) and any other affiliate located in the Western Interconnection is not a market participant. We also note that no commenter has raised a concern regarding Trimaran.

<sup>34</sup>See 18 C.F.R. § 35.34 (b) (2002) and supra note 19.

<sup>35</sup>DPL would be considered a market participant by virtue of its interests in Dayton Power, which is also a market participant.

<sup>36</sup>We note that the Commission's analysis of an applicant with voting interests in more than one market participant, even if below the five percent threshold, may result in a different conclusion.

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as well as its economic interest in a market participant and its ability to increase this interest via the warrants undermines the independence of International Transmission. Based on the facts presented in this case, we are willing to accept Applicants' proposal because KKR Millenium Fund, as a limited partner, will have no day-to-day control over International Transmission, and because of our finding above that the limited partners are not market participants. Further, pursuant to Order No. 2000, we will require Applicants to inform us promptly of any changes in the partnership agreement, or any other agreement, or new facts (including but not limited to any new financial interests acquired in market participants or any exercise by KKR of its warrants to buy DPL stock) so that we can ensure that International Transmission remains independent.

**b. Other Independence Concerns**

45. ABATE also claims that other independence concerns are raised by the nature of the management buy-out funded by KKR. ABATE notes that International Transmission's management, including DTE Energy employees who ran the auction to sell International Transmission, will receive a five percent stake in the divested company that was funded by KKR. ABATE also notes that the International Transmission's management agreed to a service agreement that would pay DTE Energy well above market prices for services currently provided by DTE Energy to run the International Transmission system.

46. In response to these concerns, Applicants state that the five percent interest in ITC Holdings to be held by employees and management of International Transmission and ITC Holdings would not be funded by KKR and merely reflects normal corporate policy of allowing such participation in order to give employees incentives to enhance productivity and efficiencies. Applicants also state that ABATE has not raised any material issue of fact that would warrant a hearing.

47. We find that the buy-out does not pose a threat to International Transmission's independence. Applicants have pledged that, post-divestiture, employees of International Transmission will not have any financial or economic stake, including defined pension or benefit rights, in DTE Energy or any other market participant, and thus would not benefit from running the system to favor DTE Energy. Finally, as discussed above, there is no need to set the independence issue for hearing. Further, concerns regarding compensation under the service agreements are addressed below.

**C. Service Level Agreements**

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48. The Purchase Agreement includes as Exhibit C, Service Level Agreements (service level agreements). Applicants state that under these agreements, Detroit Edison would provide to International Transmission certain corporate administration services<sup>37</sup> as well as construction, maintenance, engineering and system operations services in order to facilitate International Transmission's transition to a stand-alone transmission company. These services would be priced at cost plus a 25 percent overhead fee and a 9.5 percent additional fee based on an O&M formula charge. The average term of a service agreement is 24 months<sup>38</sup> unless terminated earlier, upon mutual written consent of both parties, or unilaterally by either party with respect to the Corporate Administration Services Agreement.<sup>39</sup>

49. All work and service are to be provided under the direction and control of and at the discretion of International Transmission. Applicants note that the agreements require each of the parties and all affiliates, employees and subcontractors to "explicitly agree" to comply with the Commission's OASIS standards of conduct. Applicants stress that real-time operation of the International Transmission System will be performed by International Transmission employees (in conjunction with METC employees) from a central control center in Ann Arbor, Michigan.

### **Comments and Applicants' Answer**

50. ABATE protests the fees and overhead allowances provided under the Construction and Maintenance/Engineering/System Operations Agreement. ABATE states that Detroit Edison's actual costs, plus identifiable indirect costs, in addition to the

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<sup>37</sup>Corporate Administration Services would include: (1) controller services; i.e., internal reporting, including financial statements and fixed asset recording; and (2) information systems-ISO which would maintain existing software and hardware. See Schedule A, Exhibit C of Purchase Agreement.

<sup>38</sup>Construction and maintenance services would be provided for six years and engineering services are automatically renewed for another two years, unless advance written notice is given by either party. See section 7(a) of Construction and Maintenance/Engineering/System Operations Agreement.

<sup>39</sup>The Construction and Maintenance/Engineering/System Operations Agreement allows International Transmission to unilaterally terminate its engineering services provided through its own employees. See section 7(c) of Construction and Maintenance/Engineering/System Operations Agreement.

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approximate 37 percent overhead allowance related to all work performed by Detroit Edison for International Transmission are excessive and would lead to unjust and unreasonable rates.

51. In their Answer, Applicants respond that ABATE's contentions related to the Construction and Maintenance/Engineering/ System Operations Agreement are unsubstantiated. Applicants assert that the rates in this service agreement were negotiated at "arm's length" as part of the proposed transaction and include terms the parties to the Service Agreement believe to be reasonable. In addition, Applicants state that most of the terms of the service agreements are for two years or less.

### **Commission Response**

52. Under the service level agreements, as a contractor to International Transmission Detroit Edison would be providing many of the same day-to-day functions it currently performs in its capacity as the current owner of the assets. While we believe there are valid reasons for an interim arrangement to ensure a smooth transition,<sup>40</sup> we cannot permit an agreement of this nature to continue for a protracted period of time because of its obvious threat to International Transmission's independence.

53. We recognize that Detroit Edison would assist International Transmission during this transition period and that its previous experience will be valuable. However, International Transmission must assume ultimate authority. We will, therefore, limit the period for International Transmission contracting with Detroit Edison to one year from the service commencement date. After one year, we expect International Transmission to acquire the staff and other resources necessary to operate as a transmission business entity.

54. However, if International Transmission determines that it continues to need to contract for support services, it must issue a Request For Proposal (RFP) seeking competitive bids sufficiently in advance of the end of the first year of operations such that at the beginning of the second year of operations Detroit Edison will no longer provide the required services. Any services agreement resulting from the RFP process must be with an independent entity.

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<sup>40</sup>Detroit Edison would provide accounting, bookkeeping, and IT support and make available computer hardware, software and other fixed assets which would help ensure a smooth transition for assuring delivery of service.

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55. At issue, also, is whether the service level agreements need to be filed with the Commission under section 205 of the FPA. The Commission has set forth a test in Prior Notice and Filing Requirements Under Part II of the Federal Power Act, 64 FERC ¶ 61,139 (1993) to determine when O&M-type agreements are jurisdictional under section 205. The test involved two questions: First, can the O&M service at issue be tied to wholesale sales or to transmission in interstate commerce (for instance, does the O&M agreement contain rates or charges for or in connection with transmission or sales for resale in interstate commerce, or does it in any manner affect or relate to jurisdictional rates or services)? Second, does a public utility provide the O&M service? If the answer to both questions is yes, then the O&M agreement must be filed for Commission review.<sup>41</sup>

56. Applicants have included the Purchase Agreement under the FPA section 203 in the application. However, they specifically request approval of only the MOA, GIA and CIA under the FPA section 205. We believe that the service level agreements are also jurisdictional under section 205. Not only will the costs of these services be ultimately reflected in rates charged by International Transmission, but Detroit Edison's actions under the service level agreements (*i.e.*, constructing, operating and maintaining transmission facilities) directly involve the provision of jurisdictional services. Finally, Detroit Edison would continue to operate facilities used to provide transmission in interstate commerce that are subject to the Commission's jurisdiction under FPA 205.<sup>42</sup>

57. Accordingly, we find that the service level agreements submitted in the instant filing as well as any service agreements negotiated for time periods beyond the first year of service must be filed under section 205 of the FPA.

## **D. Proposed Rate Treatments**

### **1. ADIT Adjustment**

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<sup>41</sup>We note that even if the entity providing the O&M service is not a public utility, if such O&M service is being provided to a public utility (such as an independent transmission company or RTO), the Commission has the authority to require that the agreement be filed by the public utility for whom the O&M service is being provided because it is a contract affecting that public utility's jurisdictional services.

<sup>42</sup>See Bechtel Power Corp., 60 FERC ¶ 61,156 (1992). We also note that Detroit Edison would provide Wholesale Distribution Service, which is subject to the Commission's jurisdiction under section 205 of the FPA.

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58. Applicants seek approval to defer and recover through the Attachment O rate formula an amount equal to the balance of accumulated deferred income taxes on International Transmission's books at closing estimated to be \$59 million. The deferred amount will be amortized equally over twenty years from the closing date and included in the Attachment O formula rate.

59. Applicants state that the ADIT adjustment is necessary so that ITC Holdings can offer DTE Energy a purchase price that will provide the necessary incentive for DTE Energy to sell International Transmission and for assurance that International Transmission will be able to recover this amount. Applicants state that this is the same treatment that was approved in Trans-Elect with respect to the sale of Michigan Electric Transmission Company.

#### **Intervenors' Comments and Applicants' Answer**

60. ABATE argues that the proposed ADIT adjustment has not been justified as applicants are not independent.

61. In their Answer, Applicants state that: (1) the divestiture of International Transmission to ITC Holdings LP would result in International Transmission operating as a completely independent, for-profit transmission company under the Midwest ISO umbrella; (2) KKR and KKR Millennium Fund are not market participants and are not affiliates of International Transmission; and (3) International Transmission's management and employees would not have financial ties to any market participant.<sup>43</sup>

#### **Commission Response**

62. We have previously accepted the transfer of functional control of International Transmission's jurisdictional facilities to the Midwest ISO.<sup>44</sup> International Transmission's proposed business model will provide an additional layer of structural independence. This will lessen the potential for the exercise of undue discrimination in the provision of transmission service over the International Transmission's system. Moreover, we believe that International Transmission's for-profit, stand-alone transmission business will bring significant benefits through, among other things,

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<sup>43</sup>See ABATE Protest at 7 and Answer at 6-12.

<sup>44</sup>See ITC.

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improved asset management, development of innovative services, and improved access to capital markets given a more focused business model than that of vertically-integrated utilities. Given these expected benefits and our previous approval of this rate treatment under similar circumstances, we will approve the proposed ADIT adjustment.

## **2. Return on Equity and Capital Structure**

63. Applicants request a return on equity (ROE) of 13.88 percent, or 100 basis points above that approved by the Commission for participation in the Midwest ISO.<sup>45</sup> Applicants contend that the adjustment: (1) is consistent with the Commission's expressed willingness to consider a higher rate of return for greater degrees of independence,<sup>46</sup> (2) reflects the risk profile of International Transmission as an independent transmission company with no other business activities, and (3) is outweighed by the benefits of the divestiture.

64. Applicants request the use of International Transmission's actual capital structure effective as of the transaction closing date and anticipate that this capital structure will be 40 percent debt and 60 percent equity. They contend that this proposal is consistent with the Midwest ISO Attachment O formula rate, reflects the fact that International Transmission will be responsible for the payment of its own debt and maintenance of its own credit rating and is needed to achieve an investment grade credit rating so that it can attract capital to make transmission investment.<sup>47</sup>

### **Intervenors' Comments and Applicants' Answer**

65. ABATE challenges both the proposed ROE and the expected capital structure. ABATE faults Applicants' one-step discounted cash flow (DCF) model, and states that the highpoint of the zone of reasonableness was developed by reference to Alliant Energy. ABATE states that Alliant Energy's subsequent announcement that it was reducing its dividends by half calls into question whether the implied cost of equity is as high as indicated in the exhibit. ABATE faults the model for only including two

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<sup>45</sup>See Midwest Independent Transmission System Operator, Inc., 100 FERC ¶ 61,292 (2002), order denying reh'g, 102 FERC ¶ 61,143 (2003) (Midwest ROE).

<sup>46</sup>In support, Applicants cite to Midwest ROE, 100 FERC ¶ 61,292 at P 31 .

<sup>47</sup>See Application at 56-61.

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estimates of sustainable growth rates rather than three estimates.<sup>48</sup> ABATE argues that the proposed capital structure would lead to unjust and unreasonable rates because of a higher than normal equity percentage and that International Transmission's proposed pricing does not reflect the cost of providing service as articulated in Order No. 2000.<sup>49</sup>

66. Applicants disagree with ABATE's claims that the DCF analyses are flawed. Regarding the high point developed with reference to Alliant Energy, Applicants state that ABATE's adjustment should be made both to the numerator and the denominator (the utility's stock price). On ABATE's argument that Applicants used an insufficient number of growth estimates, Applicants state that, at the end of 2002, when the International Transmission's analysis was prepared, only two forward-looking projections were available from Value Line. As to the proposed capital structure, Applicants argue that the use of International Transmission's actual capital structure upon closing is consistent with the Midwest ISO Attachment O formula.<sup>50</sup>

67. In its data request, the Commission requested support for Applicant's expected capital structure. Applicants stated that although the base purchase price for International Transmission is \$610 million in the Purchase Agreement, the application filed in this proceeding does not seek to reflect the full purchase price in International Transmission's rates, rather the 60 percent equity ratio is represented by just over \$279 million in equity contribution of certain investment funds of ITC Holdings.

### **Commission Response**

68. We will accept the Applicants' proposed ROE of 13.88 percent. It is appropriate for Applicants to receive a 100 basis point adder in this particular instance. The Michigan Commission has long supported this early effort at independent transmission company formation, and independent operation of the transmission assets is an important policy objective of the Commission.<sup>51</sup> While this transaction is afforded the use of two

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<sup>48</sup>In support, ABATE cites Midwest ROE, 100 FERC ¶ 61,292 at P 17.

<sup>49</sup>In support, ABATE cites Order No. 2000 at 31,173.

<sup>50</sup>See ABATE Protest at 6; see also, Applicants' Response to staff data request at 2-1, 2-2 and 2-3, and Answer at 14-19.

<sup>51</sup>See Proposed Pricing Policy for Efficient Operation and Expansion of

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ratemaking tools discussed in the proposed policy statement, we do not intend for this to be the case for future transactions. We will accept the capital structure as proposed consistent with the Midwest ISO Attachment O formula. International Transmission's anticipated equity ratio of 60 percent of total capitalization, while high, is close to the range of equity ratios for firms in the Midwest ISO group.<sup>52</sup>

### **3. Deferred Recovery of Revenues under Attachment O**

69. Applicants seek to recover on a deferred basis starting January 1, 2006, the difference between the revenue that will be charged under a rate of \$1.075/kW-month and revenue that would have been collected for service in the International Transmission pricing zone using the Attachment O formula under the Midwest ISO OATT and JOATT.<sup>53</sup> The deferred amount will be amortized over five years once the rate period ends and included in the Attachment O formula rate. Applicants state that the deferral will be calculated annually using International Transmission's FERC Form 1 data and posted on the Midwest ISO OASIS in the same manner as the transmission service rates that apply to other Midwest ISO transmission owners. Applicants state that the deferral mechanism is necessary so that International Transmission is not discouraged from investing in needed transmission infrastructure during the rate freeze.

70. Applicants also request various miscellaneous adjustments to implement the Attachment O deferral. These adjustments were not protested and are accepted unless noted otherwise regarding the duration of the proposed rate treatment.<sup>54</sup> We will require

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<sup>51</sup>(...continued)

Transmission Grid, 102 FERC ¶ 61,032 (2003).

<sup>52</sup>See Exhibit No. IT-300 at 42. Applicants state that common equity ratios at year-end 2001 ranged from 36.7 to 58.1 percent.

<sup>53</sup>See Purchase Agreement, Section 5.13.

<sup>54</sup>See Application at 49 - 54, 62 and Purchase Agreement, sections 5.13 and 5.14 and Exhibits A and B. From the closing date through May 31, 2004, the proposal includes: (1) use of International Transmission's 2002 FERC Form No. 1 data; (2) adjustments necessary to reflect the change in control and disaggregation of International Transmission from a vertically-integrated utility to a true stand-alone transmission company; and (3) adjustments necessary to reflect all of the fundamental elements of the

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a compliance filing by Applicants, within 30 days of the date of issuance of this order, explaining their proposal to calculate the Attachment O deferral from June 1, 2004 through December 31, 2004, instead of from June 1, 2004 through May 31, 2005.

### **Intervenors' Comments and Applicants' Answer**

71. ABATE objects to the proposed Attachment O deferral as unreasonable based on its claim that International Transmission lacks independence. ABATE argues that Section 5.13 of the Purchase Agreement only allows Detroit Edison to challenge the Attachment O deferral (subject to threshold levels of annual expense or capital expenditures), and that this limitation is an inadequate safeguard against excessive investment and/or expenses. In addition, ABATE contends that, unlike the instant case, the deferral approved in Trans-Elect was limited to important upgrade, interconnection and capital costs, particularly those mandated under Michigan law.

72. Michigan Commission seeks clarification that there is no determination that the costs incurred during the rate freeze period and accrued in the Attachment O are just and reasonable and states that it retains all rights to challenge the data inputs and prudence of expenditures during the rate freeze period to the extent that such expenditures are reflected in the Attachment O deferral accrued during the rate freeze period.<sup>55</sup> Further, the Michigan Commission contends that challenges to such data inputs and the prudence of any such costs can be made at any time up to and including the period that Attachment O deferrals are being amortized and recovered in rates commencing January 1, 2006, through December 31, 2011.<sup>56</sup>

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<sup>54</sup>(...continued)

proposed transmission rates (e.g., creation of a rate base item equal to the unamortized balance of the ADIT adjustment).

<sup>55</sup>The Michigan Commission states that it does not object to the Applicants' requested rate approvals based on its understanding that the limitations on Seller and its affiliates to challenge the reasonableness of International Transmission's costs for amounts that exceed certain threshold levels rights do not apply to any other party. See Michigan Commission Comments at 3, n.2.

<sup>56</sup>See ABATE Protest at 5, 6 and 8, Michigan Commission Comments at 3, 4 and Answer at 19, 26.

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73. Applicants clarify that they did not intend to limit non-parties to the Purchase Agreement from challenging expenses reflected in the Attachment O deferral concerning their own rates, and that non-parties are not subject to the threshold levels set forth in Section 5.13(d) of the Purchase Agreement. They explain that the threshold levels are within DTE Energy's projections of a prudent level of International Transmission's expenses and expenditures on a going forward basis and consider the historic level of such expenses incurred during DTE Energy's ownership. Applicants agree to the Michigan Commission's clarifications that: (1) there has been no determination that the costs incurred during the rate freeze period and accrued in the Attachment O deferral are just and reasonable and (2) while the rights of Seller and its affiliates to challenge the reasonableness of International Transmission's costs are limited to amounts that exceed certain threshold levels, such limitations on prudence challenges do not apply to any other party.

### **Commission Response**

74. We will accept Applicants' request for the Attachment O deferral, subject to the following discussion. Consistent with our finding in Trans-Elect, we will deny an extension of the rate freeze and deferral mechanisms beyond January 1, 2005, the period established under section 35.34(e)(4) of the Commission's regulations,<sup>57</sup> but note that nothing prevents International Transmission from filing with the Commission at least sixty days before the end of the moratorium period, proposed rate treatments for service beyond January 1, 2005. If International Transmission files such a proposal, it will have to support its proposal on grounds other than section 35.34(e) of the Commission's regulations.

75. ABATE misstates that section 5.13(d) of the Purchase Agreement allows Detroit Edison to challenge the Attachment O deferral (subject to threshold levels of annual expense or capital expenditures), and that no other party may challenge any expenditures. They contend that this mechanism is an inadequate safeguard against excessive investment and/or expenses. However, the Purchase Agreement sets a threshold level only for challenges made by DTE and its affiliates of the reasonableness of any capital expenditures and controllable expenses, but not for any such challenges brought by non-parties, including the Commission.

76. In addition, the Purchase Agreement proposes to bind non-parties and the

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<sup>57</sup>18 C.F.R. § 35.34(e)(4) (2002).

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Commission acting sua sponte, absent agreement by the parties to the agreement, to the public interest standard of review under the Mobile-Sierra doctrine regarding any proposed changes to certain aspects of the proposed rate.<sup>58</sup> Applicants state that these provisions are based upon the Commission's proposed policy statement regarding the standard of review that must be met to justify proposed changes to market-based rate contracts for wholesale sales of electric energy.

77. The proposed language conflicts with Commission precedent against binding the Commission, without its consent, to a public interest standard of review. As we have explained, we are not bound to employ a public interest standard of review when we undertake our initial review of an agreement or when we are acting sua sponte or at the request of non-parties to change rate, terms and conditions in order to protect non-parties.<sup>59</sup> While we have proposed to change this policy with regard to market-based power sales,<sup>60</sup> the rationale for that proposed policy change does not apply here, where we are dealing with transmission service (by its nature a monopoly service) and with a contract that is essentially seeking to set not only the respective rights and obligations of the contractual parties, but also the rates that third parties will pay.

#### **4. Effective Transmission Rate and Refund of Point-to-Point Revenues**

78. Applicants' proposal includes a transmission rate of \$1.075/kW-month adjusted for refunds of point-to-point (PTP) transmission service revenues associated with transactions that would not be included in the divisor for the International Transmission

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<sup>58</sup>See sections 5.13(e)(i) and (ii) of the Purchase Agreement.

<sup>59</sup>See, e.g., Florida Power & Light Co., 67 FERC ¶ 61,141 at 61,398-99 (1994); Southern Company Services, Inc. 67 FERC ¶ 61,080 (1994).

<sup>60</sup>Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities, 67 Fed Reg. 51,516 (2002) (Docket No. PL02-7-000).

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zonal licence plate rate pursuant to the Attachment O formula effective on the closing date through December 31, 2005.<sup>61</sup>

79. Applicants state that \$1.075/kW-month is the last “clean rate” on file, resulting from the application of the Attachment O rate formula to Detroit Edison's 2000 FERC Form No. 1 and in effect during the period beginning January 1, 2002, through May 31, 2002. According to Applicants, \$1.075/kW-month is also the rate that has been charged since June 1, 2002, pending the outcome of the rate proceeding in Docket No. ER02-1963-000.<sup>62</sup> They further state that the rate freeze and point-to-point revenue crediting is consistent with the Michigan Commission's desire for rate stability during the transition to retail competition.

### **Intervenors' Comments and Applicants' Answer**

80. DIG protests the proposed rate as not being the current just and reasonable rate and contends that the just and reasonable rate for the current Attachment O rate period will result from either a settlement or a final Commission order following a hearing in the ongoing proceeding in Docket No. ER02-1963-000. DIG requests that if the Commission

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<sup>61</sup>See Application at 65. For the closing date through December 31, 2003, International Transmission will refund 100 percent of these revenues. For calendar years 2004 and 2005, International Transmission will refund 75 percent and 50 percent of these revenues, respectively. Any PTP revenues not credited to customers while the PTP refund is in place will be credited to International Transmission's revenue requirement in accordance with the Attachment O formula.

<sup>62</sup>In Docket No. ER02-1963-000, Midwest ISO and International Transmission proposed certain modifications to the Midwest ISO Attachment O formula applicable to International Transmission, effective June 1, 2002, in order to accommodate the fact that International Transmission's 2001 FERC Form No. 1 reflected only partial-year data because it existed as a stand-alone company for only part that year. By order issued July 19, 2002, the Commission accepted those proposed modifications for filing, subject to refund, set them for hearing, held the hearing in abeyance, and established settlement judge procedures. Settlement negotiations are ongoing. The rate resulting from the Attachment O formula, with proposed modifications, was \$1.21/kW-month. However, according to Applicants, the International Transmission zonal rate under the Midwest ISO tariff has been discounted to \$1.075/kW-month, since June 1, 2002, pending the outcome of Docket No. ER02-1963-000.

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approves the proposal to freeze the current rate, at a minimum, such approval should be made subject to the final outcome in Docket No. ER02-1963-000. Michigan Commission does not object to Commission approval of the proposed \$1.075/kW-month rate as the just and reasonable rate beginning at the closing date.<sup>63</sup>

81. Applicants answer that the effective transmission rate, net of the PTP revenue credits, would result in a rate for the International Transmission pricing zone of approximately \$0.983/kW-month in 2003 based on projected PTP revenues. Applicants argue that a higher rate freeze level would not satisfy the Michigan Commission's desire for rate stability during the transition to retail competition and that implementation of a lower rate freeze level could jeopardize the ability of parties to consummate the transaction since International Transmission must generate sufficient cash flow to meet financing needs.

### **Commission Response**

82. We will accept the proposed transmission rate of \$1.075/kW-month adjusted for credits of point-to-point transmission service revenues, effective on the closing date. As Applicants note, the effective proposed rate is lower than the current rate of \$1.075/kW-month being charged under the Midwest ISO OATT and JOATT, which, in turn, was the last clean rate applicable to the International Transmission licence plate pricing zone. DIG does not identify any aspect of the proposed effective rate for us to question its justness and reasonableness going forward. Also, the true-up against the Attachment O rate formula (i.e., the deferred recovery of the difference in revenue between what would have been collected under Attachment O and what will be collected under the effective rate) addresses concerns about potential over-recovery of costs due to the effective rate. Finally, we understand from Applicants that near-term rate certainty will help facilitate consummation of this transaction and believe that the proposed effective rate is a reasonable basis to provide that certainty.

### **E. Master Operating Agreement, Generator Interconnection Agreement, and Coordination and Distribution Interconnection Agreement, Secondment Agreement**

83. The MOA between Detroit Edison and International Transmission clarifies existing day-to-day operational arrangements within the MACS Control Area. The Generator Interconnection Agreement (GIA) governs the interconnection and parallel

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<sup>63</sup>See DIG Protest at 7, 8 and Michigan Commission Comments at 3.

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operation of all of Detroit Edison's generation resources with the International Transmission System. The Coordination and Distribution Interconnection Agreement (CIA) governs the rights, obligations and responsibilities of the parties regarding the coordinated operation and wires-to-wires interconnection of Detroit Edison's distribution system with the International Transmission System.

### **Comments and Applicants' Answer**

84. METC expresses concern that the MOA could be construed as imposing obligations on METC or affecting METC's rights as a joint control area operator. METC wants assurance from the Commission that it cannot be bound by any agreement without its consent. METC requests that the Commission state that any action it takes with respect to the MOA or any other agreement does not bind METC. In their Answer, Applicants voice no objection to METC's request.

85. METC also wants assurance that there will be no decision on Detroit Edison's obligation to pay for transmission service related to the Ludington Pumped Storage Hydroelectric Generating Plant (Ludington Facility),<sup>64</sup> as this issue is not before the Commission. METC identifies Article 5 of the MOA which addresses the issue of whether Detroit Edison should pay for transmission service in connection with its use of the Ludington Facility. Further, METC states that provisions in Article 3 of the MOA, which obligates International Transmission to take certain actions to facilitate Detroit Edison's role as a sub-control area operator, could conflict with other unspecified obligations that International Transmission has with METC. In their Answer, Applicants clarify that they are not asking the Commission to decide these issues in this proceeding, and assert that they know of no potential conflicts regarding any unspecified obligations that International Transmission has with METC.

86. METC identifies Article 8 of the MOA, which sets forth the parties' positions and

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<sup>64</sup>Ludington is a pumped storage hydroelectric facility which is located in the METC pricing zone under the Midwest ISO OATT.

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mutual obligations concerning lost pancaking charges<sup>65</sup> and would prohibit International Transmission from being party to any action whereby Detroit Edison would incur lost pancaking charges. METC asserts that International Transmission could be prevented from entering into a settlement that includes any lost pancaking charge recovery, even if Detroit Edison were willing to accept a certain level of these charges.<sup>66</sup> They request that Article 8 be modified to indicate that International Transmission can agree to any lost pancaking charges that Detroit Edison is willing to pay. In their Answer, Applicants explain that the Midwest ISO has filed a revised tariff in Docket No. ER03-366-000 which would have the effect of terminating the existence of the JOATT as of January 1, 2003, as directed by the Commission. Applicants assert that the MOA's effective date of the consummation of the transaction, which would occur subsequent to the requested effective date for the Midwest ISO's filing to terminate the JOATT, would render the issue moot. Applicants note that Article 8 of the MOA prohibits International Transmission's from initiating, causing, influencing or supporting actions before the Commission that would change any currently applicable tariff, rate schedule, or protocol which would have the effect of causing Detroit Edison to incur lost pancaking charges. In contrast, they state that the Midwest ISO, which is not a party to the MOA, can pursue such actions. Further, Applicants state that this provision would not prohibit Detroit Edison from entering into a settlement agreement to resolve such issues, and could not prevent the Midwest ISO transmission owners from implementing a settlement or a Commission order that is otherwise in the public interest. They emphasize that Article 8 states that International Transmission will comply with the Commission rules and regulations and applicable law.

87. METC expresses concern that, pursuant to a Secondment Agreement,<sup>67</sup> its use of a

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<sup>65</sup>See Article 8 of MOA ("[International Transmission] shall not initiate, undertake, cause, influence or support any action before FERC to change any currently applicable tariff, rate schedule or protocol which would have the effect of causing Detroit Edison to incur Lost Pancaking Charges or would terminate the existence of the Joint OATT.").

<sup>66</sup>For example, METC cites to Docket No. ER02-1420, where the Commission set for settlement, the lost pancaking charges features of the tariff that would result from the proposed merger between the Midwest ISO and the Southwest Power Pool.

<sup>67</sup>The Secondment Agreement between Consumers Energy and Trans-Elect was submitted as part of an application to transfer Consumers' interests in Michigan Transco, (continued...)

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number of Consumers' employees on a contract basis to perform control area functions may give Detroit Edison a right to terminate the MOA pursuant to section 11.2 of the MOA, which prohibits METC to allow any of its duties as a joint control area operator to be performed by a market participant or any affiliate. In response to METC's request for clarification, Applicants answer that the MOA imposes no limit on METC's contractual relationships with third parties.

88. METC also states that Exhibit 1 to the Coordination and Distribution Interconnection Agreement is unclear regarding whether phase shifter facilities are being transferred to International Transmission. Applicants answer that the phase shifter are included in the facilities being transferred as part of the proposed transaction.

### **Commission Response**

89. We find that the concerns raised by METC have been adequately addressed by Applicants. We find the Master Operating Agreement, the Generator Interconnection Agreement and the Coordination and Distribution Interconnection Agreement to be just and reasonable and will accept them pursuant to section 205 of the FPA.

### **F. Section 203 Request to Divest International Transmission**

#### **1. Standard of Review under FPA section 203**

90. Section 203(a) of the FPA provides that the Commission shall approve a

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<sup>67</sup>(...continued)

LLC to Michigan Transco Holdings, LP., and provides for services to Trans-Elect, after closing, by certain employees of Consumers, for a period of up to two years. See Trans-Elect. METC states that it has offered employment to Consumers' employees that it had hired on a contract basis to perform control area functions. Those employees accepting employment will be transitioned during the service period of the Secondment Agreement. METC explains that during the service period, METC has full control over these employees, who do not have any duty of loyalty to Consumers, but owe a duty of confidentiality to METC. These employees will remain on Consumers' payroll, however, METC will reimburse Consumers for their salaries, wages and employee benefits on an actual cost basis.

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proposed disposition if it finds that the disposition "will be consistent with the public interest."<sup>68</sup> As we stated in DTE, we will complete our review of the divestiture transaction, now that the buyer of International Transmission has been determined. The Commission generally takes account of three factors in analyzing proposed mergers and other section 203 transactions: (a) the effect on competition; (b) the effect on rates; and (c) the effect on regulation.<sup>69</sup> In this case, as discussed above, our prior order preliminarily approving the disposition stated that in evaluating competitive concerns raised by the proposed divestiture, the Commission, inter alia, would determine whether the purchaser of International Transmission is affiliated with any market participant.<sup>70</sup>

**a. Effect on Competition**

91. Applicants state that the divestiture will not adversely affect competition.

Applicants state that as the divestiture will not result in a vertical combination of generation and transmission assets or a merger of public utilities, there is no need to conduct the horizontal or vertical competitive screen analyses in sections 33.3 and 33.4 of the Commission's regulations. Applicants also explain that neither International Transmission nor ITC Holdings own any electric generation facilities and that there will be no change in the ownership or control in any electric generation facilities resulting from the transaction. Applicants claim that the transaction would not involve competitive concerns with respect to the ownership or operation of transmission facilities.

92. As we stated in DTE, anticompetitive effects are unlikely to arise in a transaction

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<sup>68</sup>16 U.S.C. § 824b(a) (2000).

<sup>69</sup>See Revised Filing Requirements Under Part 33 of the Commission's Regulations, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs. ¶ 31,111 at 33,362-63 (2000), order on reh'g, Order No. 642-A, 94 FERC ¶ 61,289 (2001); see also Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stat. and Regs. ¶ 31,044 at 30,117-18 (1996), reconsideration denied, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement).

<sup>70</sup>See DTE at 62,572.

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that only involves a disposition of transmission facilities.<sup>71</sup> However, the Commission indicated that it would make a final determination on the competitive effects of the International Transmission divestiture after the buyer of International Transmission had been selected. The Commission stated that it would determine whether the buyer is "affiliated with any market participant, including whether it is affiliated with any entity whose economic or commercial interests are significantly affected by an RTO's actions or decisions."<sup>72</sup> The Commission also stated that it would consider whether the buyer presents other competitive or public interest concerns.

93. Based on the foregoing analysis of International Transmission's independence, we have concluded that ITC Holdings and ITC Holdings LP are independent. We further conclude that the buyer of International Transmission presents no other competitive or public interest concerns. Except for concerns raised by ABATE, whose arguments we have addressed above, no intervenor has alleged that competition would be adversely affected. Finally, as we noted in the DTE, despite a change in the stock ownership of International Transmission's facilities, these facilities would continue to be subject to our open access requirements under Order No. 888 and Order No. 2000.

**b. Effect on Rates**

94. Applicants submit that the proposed divestiture will not adversely affect rates. Applicants state that the application includes a straightforward rate mechanism that is designed to work within the Midwest ISO Attachment O formula rate, mitigate any rate impacts and accommodate the need for rate stability during the transition to competitive retail electricity markets in Michigan. They state that any adverse rate effects will be far outweighed by significant transaction benefits.

95. Further, Applicants state that rate mitigation measures would mitigate any adverse rate effects from the transaction. Applicants state that they would freeze the rate for transmission service under the Midwest ISO OATT and Midwest ISO JOATT, concurrently with the retail rate freeze in effect under the Michigan Restructuring Act (through December 31, 2005), and that this rate freeze would facilitate the development

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<sup>71</sup>See DTE at 62,573 (citing Order No. 642 at 31,902).

<sup>72</sup>Id. (citing Order No. 2000 at 31,061-62).

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of competitive retail electric markets in Michigan.<sup>73</sup> Applicants state that any adverse rate effects will be mitigated through direct refunds of certain point-to-point revenues through the PTP Refund Mechanisms. According to Applicants, after giving effect to the PTP Refund, customers can expect to pay less than the \$1.075/kW/month rate during the rate freeze period. Finally, Applicants claim that the sharing of sale proceeds between DTE Energy and Michigan ratepayers, as provided for in the Michigan Commission's Accounting Order would mitigate adverse rate effects of the proposed divestiture.

96. As discussed earlier, ABATE and DIG raise concerns with several aspects of Applicants' proposed rate treatments to become effective following consummation of the divestiture transaction. ABATE questions whether Applicants have made an adequate independence showing to justify the proposed rate treatments and whether the rate proposal itself will result in just and reasonable rates. DIG does not question the efficacy of the proposed transmission rate freeze through December 31, 2005, but argues that the rate itself should be made subject to the final outcome in Docket No. ER02-1963-000.

97. No change is proposed in wholesale power rates by Detroit Edison as a result of this filing and no intervenor has raised concerns about adverse impacts on wholesale power rates. We find that the proposed transaction will not adversely affect wholesale power rates. While the divestiture and proposed transmission rate treatment are clearly interrelated, neither ABATE nor DIG has requested that a hearing be held under section 203 on the effects of the divestiture on transmission rates. Also, neither has challenged the length of the proposed rate freeze. In addition, neither has sought any other type of ratepayer protection from the effects of the proposed transaction. Rather, ABATE and DIG appear to have presented rate issues in a section 205 context and those issues have been addressed in the section 205 analysis, *supra*. Accordingly, the Commission finds that a hearing or any other remedy regarding rate issues is not necessary insofar as section 203 is implicated.

**c. Effect on Regulation**

98. According to Applicants, the divestiture will not adversely affect federal

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<sup>73</sup>In support, Applicants state that in approving Detroit Edison's accounting treatment of the proposed transaction, the Michigan Commission noted the "substantial value" of International Transmission's commitment to seek a transmission service rate freeze during the transition to retail competition. *See* Application at 32.

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regulation, consistent with the Commission's findings in DTE<sup>74</sup> They assert that following the divestiture, International Transmission will remain subject to the Commission's regulation, and further, that any wholesale sale of electricity by Detroit Edison and its affiliates will continue to be fully subject to Commission regulation. Applicants also point out that the Commission will lose no ability to regulate intra-system transactions, as neither International Transmission, ITC Holdings, nor DTE Energy are registered holding companies under PUHCA.

99. We find that federal regulation would not be impaired, and we further note that no intervenor alleges that federal regulation would be impaired.

100. Applicants also contend that state regulation would not be impaired by the divestiture. They state that the Michigan Commission will continue to regulate the rates, terms and conditions of retail services provided by Detroit Edison. They note that the Michigan Commission has granted all necessary State approvals for the divestiture, including Detroit Edison's request for approval of the accounting treatment of the transaction, and has determined that the divestiture satisfies critical components of the Michigan Restructuring Act.

101. Where a state has authority to act on the transaction, the Commission will not set for hearing the issue of the effect on state regulation.<sup>75</sup> Here, the Michigan Commission, the only state commission affected by the proposed transaction, has filed comments in support, but seeking certain clarifications, as previously noted. Applicants have agreed with the requested clarifications. No entity has raised concerns that the divestiture will adversely affect state regulation. Based on the factors listed above, we find that state regulation would not be adversely affected by the proposed transaction.

## **2. Jurisdictional Facilities Issue**

102. DIG argues that certain transmission facilities that should be transferred over to the Midwest ISO have not been included in Exhibit H (Jurisdictional Facilities and Securities Associated With or Affected by the Transaction) of the Application. In their answer, Applicants agree that the facilities have not been included in the proposed transaction, and assert that the status of these facilities is better resolved

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<sup>74</sup>DTE, 97 FERC at 62,573.

<sup>75</sup>Merger Policy Statement at 30,125; Order No. 642 at 31,914-15.

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in Docket No. ER03-19-000, which is currently before the Commission. We agree with Applicants that the issue of whether these facilities should be included in Exhibit H should be made subject to the outcome of the Commission's pending decision in Docket No. ER03-19-000, et al.<sup>76</sup>

### **G. Accounting Discussion**

103. ITC Holdings proposes to acquire from DTE Energy, for \$610 million, all of the outstanding capital stock of International Transmission. According to the application, the purchase will be accounted for as an acquisition of International Transmission by ITC Holdings under the purchase method of accounting, in accordance with Generally Accepted Accounting Principles. Applicants submitted certain proposed journal entries (Attachment 5) that addressed the anticipated accounting for certain ratemaking items identified as the "ADIT adder, the Attachment O deferral and the rebate of point to point service revenue ratably to all transmission customers." We cannot determine from the information provided, however, whether the proposed journal entries comply in all respects with the Commission's Uniform System of Account requirements with respect to these items. Moreover, Applicants have not adequately explained how or why these are the only accounts affected by this transaction under the purchase method of accounting when the consideration paid exceeded International Transmission's pre-divestiture net

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<sup>76</sup>In ITC, the Commission directed Applicants to provide the Commission with an updated final list of all of the jurisdictional facilities, together with information about their customers, and the contracts, tariffs, and service agreements being transferred within 30 days of the date of the order. International Transmission filed concerning the list of transmission service agreements entered into by International Transmission under the International Transmission Open Access Transmission Tariff (OATT) and Joint Open Access Tariff (JOATT) which is now part of the Midwest ISO's OATT. On May 22, 2002, the Commission conditionally accepted the Applicants' compliance filings and directed the submission of a revised compliance filing that reflects the transfer of functional control of certain transmission facilities (Baxter sub-station, the 230 kV Navarre-DIG line, and the 230 kV Baxter-DIG line) to the Midwest ISO. On July 16, 2002, Applicants submitted a filing in Docket No. ER01-3000-006, RT01-101-006, EC01-146-006 to comply with the Commission's May 22 Order, and they continued to argue that a portion of the Baxter sub-station and the Navarre-DIG line were not jurisdictional facilities subject to transfer to the Midwest ISO. Applicants subsequently submitted an Agency Agreement between International Transmission and the Midwest ISO in Docket No. ER03-19-000, which is currently before the Commission.

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assets by \$268 million.<sup>77</sup> In that instance, application of the purchase method of accounting would typically result in establishing a new basis of accounting for all of the acquired company's net assets.

104. Under the circumstances we will require International Transmission to submit its proposed accounting for all aspects of the divestiture transaction, including the ratemaking items noted above, within 30 days of the date of issuance of this order. The filing should provide a complete explanation of the basis for the proposed accounting with reference to applicable Commission accounting regulations and/or relevant accounting standards of the Financial Accounting Standard Board.

The Commission orders:

(A) The late-filed motions to intervene are hereby accepted and late-filed protests are hereby rejected for consideration, as discussed in the body of this order.

(B) The answers to comments and protests are hereby accepted, as discussed in the body of this order.

(C) Applicants' rate proposal is hereby accepted in part and rejected in part, as discussed in the body of this order.

(D) Applicants proposed agreements are accepted for filing, as designated in its filing, and as modified in the body of this order, and Applicants are hereby directed to file, within 30 days of the issuance of this order, a compliance filing, as discussed in the body of this order.

(E) The proposed transaction is authorized upon the terms and conditions and for the purposes set forth in the application.

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

(G) The foregoing authorization is without prejudice to the authority of this Commission or any other regulatory body with respect to rates, service, accounts,

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<sup>77</sup>Compare International Transmission's total equity of \$341.855 million with \$610 million consideration paid for International Transmission common stock. See Applicant's January 28, 2003 response to staff data request.

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valuation, estimates or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(H) 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.

(I) Applicants are hereby directed to notify the Commission, within 10 days of the sale, when the disposition of jurisdictional facilities is consummated.

(J) International Transmission shall submit within 30 days of the date of this order, its proposed accounting for the divestiture transaction as discussed in the body of this order.

(K) Applicants must promptly inform the Commission of any change in circumstances that would reflect a departure from the facts the Commission has relied upon in reviewing the proposed transaction.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.