

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

ITC Holdings Corp.)	Docket No. EC06-123-000
)	
International Transmission Company)	
)	
Michigan Transco Holdings, Limited Partnership)	
)	
Michigan Electric Transmission Company, LLC)	
)	
Trans-Elect NTD Path 15, LLC)	

**NOTICE OF INTERVENTION AND PROTEST OF
THE MICHIGAN PUBLIC SERVICE COMMISSION**

Pursuant to Rules 211 and 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“Commission”), 18 C.F.R. §§ 385.211 and 385.214 (2005), the Michigan Public Service Commission (“MPSC”) provides its notice of intervention and protests the May 19, 2006 Application (the “Application”) filed by ITC Holdings Corp. (“ITC Holdings”), International Transmission Company (“ITC*Transmission*”), Michigan Transco Holdings, Limited Partnership (“MTC”), Michigan Electric Transmission Company, LLC (“METC”) and Trans-Elect NTD Path 15, LLC (“NTD Path 15”) (collectively “Applicants”).

Although MPSC supports the independent transmission company model and believes that a merger bringing METC and ITC*Transmission* under common ownership could ultimately prove beneficial to Michigan consumers, MPSC protests the Application because the Applicants have not demonstrated or otherwise committed that the transaction will have no adverse impact on customers’ rates, as the Commission requires in evaluating applications under section 203 of the Federal Power Act (“FPA”).

Accordingly, the Commission should direct the Applicants to provide further information regarding how they intend to ensure that the merger will not result in a net increase in costs to consumers beyond those that would have been incurred absent the transaction.

I. DESCRIPTION OF THE FILING

The Application states that, pursuant to a purchase agreement executed on May 11, 2006, ITC Holdings will indirectly acquire METC by acquiring all of the general and limited partnership interests in MTH (“METC Acquisition”). *See* Application at 12. The purchase price is to be paid through a combination of cash and securities of ITC Holdings, and the financing for the transaction will be obtained through issuance of ITC Holdings stock and debt. *Id.* at 13. The Applicants aver that the METC Acquisition will not alter METC’s status as a separate transmission company in a separate rate zone of the Midwest Independent Transmission System Operator, Inc. (“Midwest ISO”). *Id.* at 13. The Applicants state that ITC Holdings’ acquisition of METC “would result in the ownership of nearly all of the transmission system in the Lower Peninsula of the State of Michigan by subsidiaries of a single holding company that is fully independent of market participants.” *Id.* at 3.

The Application also requests approval of an intra-corporate reorganization involving Trans-Elect, Inc., Trans-Elect Holding Company and certain other of METC’s and NTD Path 15’s existing owners, which reorganization the Applicants state is required to separate Trans-Elect, Inc.’s and its owners’ interests in METC from their non-METC investments, which will not be part of the METC Acquisition. *Id.* at 2.

II. NOTICE OF INTERVENTION

The MPSC is an agency of the State of Michigan, created by 1939 Pub. Acts 3, Mich. Comp. Laws Ann. § 460.1 *et seq.* As the Michigan regulatory agency having jurisdiction and authority to control and regulate rates, charges, and conditions of service for the retail sale of electricity in the State, the MPSC is a “state commission” as defined in 16 U.S.C. § 796(15) and 18 C.F.R. § 1.101(k) (2005). Accordingly, the MPSC hereby provides its notice of intervention pursuant to 18 C.F.R. § 385.214(a)(2) (2005).

Copies of all pleadings and correspondence in the proceeding should be addressed to:

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III. PROTEST

A. Applicable Standards

The Commission has jurisdiction over the METC Acquisition pursuant to Section 203 of the FPA, 16 U.S.C. § 824b, which requires the Commission to approve a transaction subject to that section if, after notice and opportunity for hearing, the Commission finds that “the proposed transaction will be consistent with the public interest” and that the proposed transaction “will not result in cross-subsidization of a non-

utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest.” 16 U.S.C. § 824b(a)(4).

In assessing whether a proposed transaction subject to section 203 is consistent with the public interest, FERC considers three factors: (1) the proposed transaction’s effect on competition; (2) the proposed transaction’s effect on rates; and (3) the proposed transaction’s effect on regulation.¹ Consistent with section 203(a)(5) of the FPA, the Commission requires a showing that the transfer will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company.

MPSC’s protest concerns the “effect on rates” factor in the Commission’s section 203 analysis. The Commission has explained that its “main objective in applying this factor is to protect captive customers who are served under cost-based rates that could be adversely affected by a section 203 transaction.” Order No. 669 at P 166 (footnote omitted). In describing this factor in the Merger Policy Statement, the Commission observed that “because transmission remains effectively a natural monopoly and will continue to be regulated on a cost-of-service basis, the Commission has reason to be concerned that mergers do not affect transmission rates adversely.” Merger Policy Statement at p. 30,123.

¹ See *Inquiry Concerning the Commission’s Merger Policy Under the Federal Power Act*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reh’g denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (“Merger Policy Statement”); see also *Transactions Subject to FPA Section 203*, Order No. 669, 113 FERC ¶ 61,315 (2005), *order on reh’g*, Order No. 669-A (2006) (“Order No. 669”); *Revised Filing Requirements Under Part 32 of the Commission’s Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh’g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001).

Citing the frequent and time-consuming litigation over questions of whether the benefits outweighed the costs in previous merger cases, the Commission explained in the Merger Policy Statement that “[r]ather than requiring estimates of somewhat amorphous net merger benefits and addressing whether the applicant has adequately substantiated those benefits, we will focus on ratepayer protection.” Merger Policy Statement at p. 30,123. In order to ensure that consumers obtained the requisite protection under section 203, the Commission stated that:

Merger applicants should propose ratepayer protection mechanisms to assure that customers are protected if the expected benefits do not materialize. The applicant bears the burden of proof to demonstrate that the customer will be protected. This puts the risk that the benefits will not materialize where it belongs – on the applicants.

Id. Observing that “[w]hat constitutes adequate ratepayer protection necessarily will depend on the particular circumstances of the merging utilities and their ratepayers,” (*id.*), the Commission strongly encouraged applicants to attempt to resolve ratepayer protections issues with their customers prior to filing a section 203 application, and directed that applicants “should propose a [ratepayer protection] mechanism as part of their filing.” *Id.*

The Commission has not prescribed any specific ratepayer protection mechanism that will be appropriate in all cases, but has identified a variety of hold harmless provisions that may satisfy the Commission’s requirements, such as an open season for wholesale customers, a general hold harmless provision, a moratorium on increases in base rates, or a rate reduction. *See id.* at p. 30,124. In the absence of a hold harmless proposal by the applicant in a section 203 proceeding, the Commission has explained, it may have to resort to a formal hearing on the issue of the benefits of a proposed merger versus the expected costs. *Id.* at pp. 30,123-24.

As discussed below, the Application does not ensure that consumers will receive the full protection afforded them under section 203 of the FPA because the Applicants have not demonstrated or otherwise committed that the transaction will have no adverse impact on the rates of METC and/or *ITCTransmission* as required under the Commission's standards for evaluating transactions subject to section 203 of the FPA.

B. Applicants Have Not Demonstrated That The METC Acquisition Will Have No Adverse Impact On Rates

The Applicants do not propose any specific mechanism to ensure that the rates of METC and *ITCTransmission* will not be adversely affected by the METC Acquisition. Nor do Applicants indicate that METC and/or *ITCTransmission* have made any effort to negotiate such ratepayer protections with customers. Instead, Applicants simply assert that the METC Acquisition will have no adverse impact on rates because both METC and *ITCTransmission* will continue to use the Attachment O formula rate included in the Midwest ISO tariff. *See* Application at 24-25. The Applicants contend in this respect that the "approval requested herein will not alter in any way the rates of either *ITCTransmission* or METC." *Id.* at 25.

The fact that METC and *ITCTransmission* will continue to use their Attachment O formula rates does not necessarily mean that there will be no adverse effect on rates. The Attachment O formula rate is a cost-of-service formula rate that is updated annually based on actual cost inputs taken from the utilities' annual financial reports to the Commission for the 12-month calendar year ended six months prior to the effective date of the updated rate. Merely asserting that *ITCTransmission* and METC will continue to use formula rates says nothing about how the *level* of rates might be affected by the merger. The relevant inquiry in this situation is whether customers will be insulated from

merger-related increases in *costs* that will automatically be passed through the formula rate. *See, e.g., Consolidated Edison, Inc.*, 94 FERC ¶ 61,079 (2001) (addressing the adequacy of applicants' proposed hold harmless commitment in the formula rate context). Indeed, the fact that METC and ITCTransmission utilize cost-of-service formula rates *heightens* the need to scrutinize potential adverse rate impacts, because, absent proper ratepayer protections, merger-related cost increases will simply flow through the formula rate without any opportunity for review.

Other than a pledge that METC will not seek recovery of any goodwill or acquisition premium associated with the transaction (Application at 24), Applicants do not address whether the METC Acquisition might increase costs to METC and/or ITCTransmission to levels above what would be the case in the absence of the merger. The Application does not even contain the customary claim that the Applicants expect some O&M cost savings as a result of economies of scale and/or elimination of duplicative functions. Nor do the Applicants make any effort to quantify whether potential merger benefits could outweigh the adverse impact of any cost increases.

Moreover, there is evidence that the METC Acquisition will have a direct impact on at least some of the utilities' costs, and, without further information, it is impossible to determine whether such cost impacts will result in net merger-related cost increases to customers. For example, Applicants state that METC is proposing to refinance its long-term debt in connection with the merger. *See* Application at 29. In METC's FPA section 204 application requesting authorization for the refinancing in Docket No. ES06-49-000, METC does not identify the expected interest rate on either its proposed revolving credit facility or new first mortgage bonds. *See Michigan Elec. Trans. Co., LLC*, Docket No.

ES06-49-000, “Application Under Section 204 of the Federal Power Act for Authority to Issue Debt Securities” at 7 (May 19, 2006). To the extent that the interest rates on the new debt are higher than current rates, or if prepayment/issuance costs are significant, METC’s debt costs could increase as a direct result of the merger.

Further, Standard & Poor’s put the “BBB” credit ratings of ITC Holdings and ITC *Transmission* on credit review with negative implications as a result of the proposed merger — an action which potentially could increase the debt cost of both ITC and METC by increasing the risk premium required by investors. *See Old Dominion Elec. Coop.*, 110 FERC ¶ 61,274 at P 23 (2005) (setting for hearing whether a credit downgrade could have an adverse impact on applicants’ rates, and whether the downgrade was due to the proposed transaction).

METC also currently has a Management Services Agreement (“MSA”) with its affiliate Trans-Elect, under which METC pays Trans-Elect an annual service fee and certain expenses purportedly “to retain access to and use of Trans-Elect’s executive/managerial support and regulatory services.” *Michigan Electric Transmission Co., et al.*, Docket No. ER06-56-000, Exh. MET-4 “Prepared Direct Testimony of James H. Drzemiecki” at 11 (October 20, 2005). METC paid Trans-Elect roughly \$1 million under the MSA in 2004. *Id.* at Exh. MET-5. Applicants state that the MSA will terminate in connection with the METC Acquisition (Application at 13), and suggest that there will not be a similar agreement following the merger. *Id.* at 30. While, all else being equal, termination of the MSA might suggest a cost reduction, METC has defended recovery of the MSA costs in its pending rate case on the grounds that the costs incurred under the MSA are less than the costs METC would have incurred if the services covered

by the MSA were provided by an unaffiliated entity. *See Michigan Electric Transmission Co., et al.*, Docket No. ER06-56-000, Transmittal Letter at 18 (October 20, 2005). Without more information it is not possible to determine whether customers might face increased costs associated with the services allegedly provided by Trans-Elect under the MSA.

ITC*Transmission's* recent filing in Docket No. ER06-1006-000 to modify Attachment O to allow the use of current projected expenses and rate base (which proposal MPSC has protested) also raises the prospect that METC, as an affiliate of ITC, may attempt to adjust its Attachment O in a similar fashion. Such adjustment could have an adverse effect on rates.

The absence of any evidence and/or a commitment from the Applicants (aside from the commitment not to seek recovery of the acquisition premium) that the merger will not result in a net increase in costs to consumers beyond those that would have been incurred absent the merger leaves ratepayers with less protection than they are entitled to under FERC's policies and regulations. Accordingly, MPSC is compelled to object to the Applicants' proposal to the extent that they have failed to demonstrate that the METC Acquisition will have a benign effect on the rates of METC and ITC*Transmission*.

C. The Commission Should Require Applicants To Provide Further Information And/Or A Ratepayer Protection Commitment

To address the deficiencies in the Application concerning ratepayer protection, the Commission should direct the Applicants to provide additional information regarding expected merger-related costs and savings so that the Commission and other interested parties can gauge whether the merger is likely to result in a net increase in costs to consumers beyond those that would have been incurred absent the transaction. The

Commission could also permit the Applicants to supplement their Application to explain how any merger-related cost increases could be offset by merger-related benefits. In addition, or in the alternative, the Commission could permit Applicants to propose an appropriate ratepayer protection mechanism.

IV. CONCLUSION

As set forth more fully above, MPSC hereby provides its notice of intervention in this proceeding and protests the Application to the extent the Applicants have not demonstrated or otherwise committed that the transaction will have no adverse impact on customers' rates. The Commission should direct the Applicants to provide additional information regarding expected merger-related costs and savings to permit an analysis of whether the merger is likely to result in a net increase in costs to consumers beyond those that would have been incurred absent the transaction. In addition, or in the alternative, Applicants should be permitted to propose an appropriate ratepayer protection mechanism.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. this 12th day of June, 2006.

/s/ John E. McCaffrey
John E. McCaffrey

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