

VERIFIED STATEMENT
OF
ROCHELLE PHIPPS
PUBLIC

FINANCE DEPARTMENT
FINANCIAL ANALYSIS DIVISION
ILLINOIS COMMERCE COMMISSION

MADISON RIVER COMMUNICATIONS CORP.,
MADISON RIVER TELEPHONE COMPANY,LLC,
MADISON RIVER CAPITAL,INC.
AND GALLATIN RIVER COMMUNICATIONS,LLC

JOINT APPLICATION FOR APPROVAL OF TRANSFER OF CONTROL AND
REORGANIZATION PURSUANT TO PURSUANT TO SECTION 7-203 AND SECTION
7-204, AND FOR OTHER RELIEF.

February 8, 2005

1 **1. Q. State your name and business address.**

2 A. My name is Rochelle Phipps. My business address is 527 East Capitol
3 Avenue, Springfield, Illinois 62701.

4 **2. Q. What is your current position with the Illinois Commerce**
5 **Commission (“Commission”)?**

6 A. I am currently employed as a Senior Financial Analyst in the Finance
7 Department of the Financial Analysis Division.

8 **3. Q. Describe your qualifications and background.**

9 A. In May 1998, I received a Bachelor of Arts degree in Finance from
10 Illinois College, Jacksonville, Illinois. In May 2000, I received a Master
11 of Business Administration degree from University of Illinois at
12 Springfield. I have been employed by the Commission since June
13 2000.

14 **4. Q. What is the purpose of your testimony in this proceeding?**

15 A. I will present my evaluation of the financial implications of the proposed
16 reorganization of Madison River Communications Corp. (“Madison
17 River”), Madison River Telephone Company, LLC (“Madison River
18 Telephone”), Madison River Capital, LLC (“Madison River Capital”) and
19 Gallatin River Communications, LLC (“Gallatin River”) (collectively, the
20 “Companies”) with respect to Section 7-204(b)(4) of the Public Utilities

21 Act ("Act"). I will also present my assessment of Madison River's
22 recapitalization on its potential to impair the capital of Gallatin River.

23 **5. Q. Why is it necessary to evaluate the financial implications of the**
24 **proposed reorganization?**

25 A. Under Section 7-204(b)(4) of the Act, the Commission must find that
26 "the proposed reorganization will not significantly impair the utility's
27 ability to raise necessary capital on reasonable terms or to maintain a
28 reasonable capital structure." (220 ILCS 5/7-204.)

29 **6. Q. Summarize your findings.**

30 A. In my judgment, the proposed reorganization will not significantly
31 impair the utility's ability to raise necessary capital on reasonable terms
32 or to maintain a reasonable capital structure. This finding is based on
33 the Companies agreement to comply with conditions (5) and (6) and
34 with three reporting requirements, which are described on pages 27-29
35 of Company witness Michael Skrivan's Direct Testimony, and which I
36 have modified herein.

37 **7. Q. Describe the proposed recapitalization.**

38 A. Madison River Telephone is a privately owned limited liability company
39 that is the ultimate parent company of Madison River Capital and
40 Gallatin River. Gallatin River is an incumbent local exchange carrier in
41 Illinois. The Joint Applicants propose to reorganize and recapitalize by

42 forming a new holding company, Madison River Communications Corp.
43 (“Madison River”). In connection with the proposed reorganization,
44 Madison River will become the ultimate parent company of Madison
45 River Telephone, Madison River Capital and Gallatin River. The Joint
46 Applicants propose that Madison River become a publicly owned
47 company through an initial public offering (“IPO”) of common stock.
48 Concurrent with the Madison River IPO, Madison River Capital will
49 enter a new credit facility (“Post-IPO Credit Agreement”).

50 **8. Q. Address the effect of the proposed transaction on Gallatin River’s**
51 **ability to raise necessary capital on reasonable terms.**

52 A. Gallatin River currently generates more cash than it requires for its
53 capital expenditures. (Company responses to Staff data requests
54 RP-1.04, 1.08 and 1.13.) However, in the event Gallatin River needs
55 additional funds to support its capital expenditures, it would have to
56 rely on Madison River to access the capital markets since Madison
57 River Capital has entered into agreements that restrict the type and
58 amount of debt that Gallatin River may incur. (Company response to
59 Staff data request RP-1.12.) As part of the proposed reorganization, a
60 Post-IPO Credit Agreement will replace the existing loan agreements.
61 The Post-IPO Credit Agreement is also expected to restrict the type
62 and amount of debt that Gallatin River will be able to incur. (Company
63 response to Staff data requests RP-1.04 and 1.11.)¹ Excepting the \$75

¹ Since I have not seen the final Post-IPO Credit Agreement, I am relying on the representations of the Applicants concerning the terms and conditions that will likely be part of the Post-IPO Credit Agreement as provided in response to Staff data request RP-1.11. In response to Staff data request RP-1.01, the Applicants stated that the Post-IPO Credit Agreement will not be finalized until on or about February 28, 2005.

64 million revolving credit facility that is part of Madison River's proposed
65 recapitalization, Madison River's ability to raise capital and provide
66 additional funds to Gallatin River is questionable given Madison River's
67 high degree of financial leverage. Since Madison River may draw upon
68 the credit facility to support the operations of all its subsidiaries, a
69 portion of the credit facility should be reserved for Gallatin River.
70 Condition 6, as presented in Company witness Michael T. Skrivan's
71 Direct Testimony, addresses this concern by requiring that an
72 aggregate amount of funds equal to the higher of \$4 million, or the
73 currently approved capital expenditure budget of Gallatin River, be
74 kept available exclusively for Gallatin River. Thus, the proposed
75 reorganization would not significantly impair Gallatin River's ability to
76 raise *necessary* capital on reasonable terms.

77 **9. Q. Address the effect of the proposed transaction on Gallatin River's**
78 **ability to maintain a reasonable capital structure.**

79 A. Gallatin River currently has no debt outstanding. (Company response
80 to Staff data request RP-1.04.) Since the interest on debt is
81 tax-deductible, it has a cost advantage over common equity. Thus,
82 capital structures without any debt, like Gallatin River's capital
83 structure, are not balanced from a cost standpoint. Further, the
84 Post-IPO Credit Agreement is expected to prohibit Gallatin River from
85 issuing debt. (Company response to Staff data request RP-1.04.)
86 However, when setting rates, the Commission typically uses the parent
87 company's capital structure for subsidiaries like Gallatin River that rely
88 on that parent company to supply external capital. Thus, consideration

89 of the effect of the proposed reorganization on the parent company's
90 ability to maintain a reasonable capital structure is appropriate in this
91 case. Although the proportion of debt in Madison River's capital
92 structure will remain very high after the proposed reorganization and
93 recapitalization, the proportion of debt is expected to decline from the
94 current level.² (Direct Testimony of Michael T. Skrivan, p. 20.) From
95 this standpoint, the proposed reorganization can be deemed to
96 enhance the ability of Madison River and Gallatin River (through
97 Madison River) to achieve a balanced capital structure.

98 **10. Q. Describe the nature of your concerns regarding Madison River's**
99 **financial strength as it pertains to Gallatin River's ability to**
100 **provide reasonable and adequate service at reasonable cost.**

101 A. Madison River Capital and Madison River Telephone have issuer credit
102 ratings of B from Standard & Poor's ("S&P"). (S&P Ratings Direct,
103 www.ratingsdirect.com.) That is, Madison River Capital and Madison
104 River Telephone's current issuer credit ratings are five rating notches
105 below the minimum investment grade credit rating of BBB-. According
106 to S&P, a company with a B rating currently has the capacity to meet
107 its financial commitments, however, adverse business, financial or
108 economic conditions will likely impair the company's capacity or
109 willingness to meet its financial commitments. (Standard & Poor's,
110 *Corporate Ratings Criteria – Standard & Poor's Role in the Financial*
111 *Markets; Ratings Definitions; The Rating Process*, October 28, 2004, p.

² The total long-term debt balance will fall to \$450,000,000 from \$643,810,000. (See Attachment 1 to the Joint Application, Form S-1 Registration Statement of the Securities and Exchange Commission, p. 40.)

112 6.) Although the proposed recapitalization reduces the amount of debt
113 at the Madison River level, the degree of its financial leverage will
114 remain high. Thus, even after its reorganization and recapitalization,
115 Madison River's financial condition will not be sufficiently strong to
116 eliminate concerns about its capacity to meet its debt servicing
117 obligations during adverse conditions without draining excessive
118 amounts of cash from Gallatin River, which could be to the detriment of
119 Gallatin River's service quality.

120 **11. Q. Does the Company's proposed Condition 5 ensure that Gallatin**
121 **River will maintain sufficient funds to support its operations?**

122 A. Yes. Should Gallatin River fail to pass the service quality test
123 described in Condition 5, then Gallatin River would be prohibited from
124 paying dividends to Madison River or otherwise transferring cash to
125 Madison River through loans, advances, investments or other means
126 that would divert its moneys, property or other resources to any
127 purpose that is not essentially or directly connected with the provision
128 of non-competitive telecommunications service. (Direct Testimony of
129 Michael T. Skrivan, p. 27.) Condition 5 ensures that Gallatin River will
130 retain sufficient funds to support its operations. Madison River would
131 continue to have access to any funds that Gallatin River generates in
132 excess of the amount needed to meet the service quality standards.
133 Additionally, funds from the revolving credit facility and other sources
134 would be reserved for Gallatin River on an annual basis in the event it
135 needs additional funds.

136 **12. Q. Would this service quality condition be permanent?**

137 A. No. It would be suspended upon Madison River's notification to the
138 Chief Clerk of the Commission and the Manager of the Commission's
139 Finance Department that Madison River Capital's issuer credit rating is
140 raised to investment grade status. (Direct Testimony of Michael T.
141 Skrivan, p. 28.) Currently, Madison River Capital's issuer credit rating
142 is B from S&P and Caa1 from Moody's Investors Service. (Company
143 Response to Staff data request RP-1.04.) Investment grade status will
144 be achieved when the issuer credit rating from S&P is upgraded to
145 BBB- or above and the rating from Moody's is upgraded to Baa3 or
146 above.

147 **13. Q. Do you have any proposed revisions to Condition 5?**

148 A. Yes. Condition 5, paragraphs (d) and (e) should refer to Madison River
149 Capital, which is the entity that has been assigned issuer credit ratings
150 from both S&P and Moody's Investors. Further, since Madison River
151 Telephone currently has an investor credit rating from Standard &
152 Poor's, the new parent company, Madison River might have issuer
153 credit ratings as well. Condition 5 should take that possibility into
154 account. Thus, I recommend revising paragraphs (d) and (e) to correct
155 that reference. Condition 5 should also specify who at the Commission
156 will receive Madison River's Final Notice. Specifically, I recommend the
157 following revisions to Condition 5, paragraphs (d) and (e):

158 (d) FINAL NOTICE: When Madison River Capital's
159 issuer credit rating, from both Standard & Poor's

160 and Moody's Investors Service, improves to
161 investment grade and Madison River has no non-
162 investment grade issuer credit ratings from either
163 Standard & Poor's or Moody's Investors Service,
164 Gallatin River shall file a certified notice with the
165 Chief Clerk of the Commission and the Manager of
166 the Commission's Finance Department. , with a
167 third-party independent verification, The certified
168 notice shall indicate that Madison River Capital's
169 issuer credit rating has been upgraded to
170 investment grade and that Madison River has no
171 non-investment grade issuer credit ratings from
172 either Standard & Poor's or Moody's Investors
173 Service. A corporate officer of Madison River shall
174 certify that the notice is true and accurate, and the
175 notice shall be independently verified by a third
176 party.

177 (e) DURATION OF CONDITION: The duration of time
178 that this condition (5) shall remain in effect is until
179 Madison River Capital's issuer credit rating
180 increases to investment grade and that Madison
181 River has no non-investment grade issuer credit
182 rating from either Standard & Poor's or Moody's
183 Investors Service.

184 I propose that the reference to Madison River be stated as a negative
185 condition since Madison River might not have an issuer credit rating
186 from Standard & Poor's or Moody's Investors Service or both. Thus,
187 Madison River could meet the issuer credit rating criterion in one of two
188 ways: (1) Madison River's has investment grade issuer credit ratings;
189 or (2) Madison River has no issuer credit rating. In contrast, Madison
190 River Capital would be required to have an investment grade credit
191 rating from both Standard & Poor's and Moody's Investors Service.

192 **14. Q. Do you agree with the three reporting requirements described on**
193 **page 29 of Company witness Michael T. Skrivan's Direct**
194 **Testimony?**

195 A. I agree with two of the reporting requirements as put forth in Mr.
196 Skrivan's Direct Testimony. However, the second reporting
197 requirement incorrectly references Staff Data Request RP-1.03 rather
198 than Staff data request RP-1.11. Thus, I recommend the second
199 reporting requirement be modified to correct that reference.
200 Specifically, I recommend the following modification to the second
201 reporting requirement:

202 Gallatin River shall file with the Chief Clerk of the
203 Commission a copy of the final credit agreement, as
204 amended and restated in connection with the
205 reorganization, within 10 days of that agreement's
206 execution. The final credit agreement shall contain terms
207 consistent with Gallatin River's response to Staff data
208 request ~~RP-1.03~~RP-1.11.

209 **15. Q. Describe Schedule 2.01 of your direct testimony.**

210 A. Schedule 2.01 is the Company's confidential response to Staff data
211 request RP-1.11.

212 **16. Q. What is your conclusion?**

213 A. The first part of Section 7-204(b)(4) of the Act requires the Commission
214 to find that the proposed reorganization will not impair the utility's
215 ability to raise necessary capital on reasonable terms. In my judgment,
216 under the proposed reorganization, Gallatin River will have little, if any
217 need to access capital given that (a) Gallatin River currently generates
218 sufficient cash to fund its capital expenditure budget; (b) Condition 5
219 would prevent Gallatin River from transferring that cash if it fails to
220 meet the service quality standards described in that Condition; and (c)

221 Condition 6 requires that funding be maintained through cash or credit
222 agreements with external financial institutions for Gallatin River's
223 capital expenditures.

224 Further, the reduction in the proportion of debt in Madison River's
225 capital structure, from its current level, would enhance its ability to
226 raise further capital on reasonable terms should the need arise.
227 Nevertheless, it is unlikely that Madison River will achieve the degree
228 of financial strength necessary to raise capital on reasonable terms,
229 under most capital market conditions, until it further reduces the
230 proportion of debt in its capital structure.

231 The second part of Section 7-204(b)(4) of the Act requires the
232 Commission to find that the proposed reorganization will not impair the
233 utility's ability to maintain a reasonable capital structure. I interpret
234 "reasonable capital structure" as one that permits a utility to raise
235 capital under most market conditions and results in a reasonable
236 overall cost of capital. None of the Applicants currently maintain a
237 reasonable capital structure. As stated previously, Gallatin River has
238 no debt and the Post-IPO Credit Agreement will likely limit Gallatin
239 River's ability to issue debt that would balance its capital structure.
240 When the Commission sets rates, it typically uses a parent company's
241 capital structure to set rates for subsidiaries that rely upon that parent
242 to supply external capital. The proposed reorganization and
243 recapitalization would reduce the proportion of debt in Madison River's
244 capital structure, although that reduction in debt is unlikely to be
245 sufficient for Madison River Capital to attain investment grade credit

246 ratings from either S&P or Moody's Investment Service. From this
247 standpoint, the proposed reorganization cannot be deemed to result in
248 a reasonable capital structure but can be deemed to enhance the
249 ability of Madison River, and through Madison River, the ability of
250 Gallatin River, to achieve a reasonable capital structure.

251 In summary, the proposed reorganization will not significantly impair
252 Gallatin River's ability to raise necessary capital on reasonable terms
253 or to maintain a reasonable capital structure, if the Companies comply
254 with the conditions and reporting requirements set forth herein. Thus, I
255 do not object to the proposed reorganization, subject to the conditions
256 and reporting requirements, including my modifications to Condition 5,
257 paragraphs (d) and (e) and the second reporting requirement as
258 described previously.

259 **17. Q. Does this question conclude your direct testimony?**

260 **A. Yes.**

PROPRIETARY RESPONSE
TO STAFF DATA REQUEST RP 1.11

PROPRIETARY RESPONSE
TO STAFF DATA REQUEST RP 1.11

STATE OF ILLINOIS)
)
COUNTY OF SANGAMON) SS.)

VERIFICATION

Rochelle Phipps, on oath, states that she is a Senior Financial Analyst for the Illinois Commerce Commission; that she has read the foregoing Verified Statement of Rochelle Phipps, and is familiar with the contents thereof; and that the matters set forth in the Verified Statement of Rochelle Phipps are true and correct to the best of her knowledge, information and belief.

Rochelle Phipps
Rochelle Phipps

Subscribed and sworn before me
This 3rd day of February, 2005

Lisa Bowman

Notary Public

