

VERIFIED DIRECT TESTIMONY

OF

JANIS FREETLY

Finance Department

Financial Analysis Division

Illinois Commerce Commission

MADISON RIVER COMMUNICATIONS CORP.,  
MADISON RIVER TELEPHONE COMPANY, LLC,  
and GALLATIN RIVER COMMUNICATIONS, LLC

Joint Application for Approval and Transfer of Control and  
Reorganization pursuant to Section 7-203 and Section 7-204,  
and for Other Relief

Docket No. 06-0683

November 14, 2006

1 **Q. Please state your name and business address.**

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

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

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

8 **Q. Please describe your qualifications and background.**

9 A. In May of 1995, I earned a Bachelor of Business degree in Marketing from  
10 Western Illinois University. I received a Master of Business Administration  
11 degree, with a concentration in Finance, from Western Illinois University in May  
12 of 1998. I have been employed by the Commission in my present position since  
13 September of 1998.

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

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

20 present my assessment of Madison River's proposed recapitalization on its  
21 potential to impair the capital of the Gallatin River.

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

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

28 **Q. Please summarize your findings.**

29 A. In my judgment, the proposed reorganization will not significantly impair the  
30 utility's ability to raise necessary capital on reasonable terms or maintain a  
31 reasonable capital structure. This finding is based on the Companies agreement  
32 to comply with Conditions 5 and 6 and two reporting requirements, which are  
33 described on pages 18-20 of Company witness Michael Skrivan's Direct  
34 Testimony.

35 **Q. Please describe the proposed recapitalization.**

36 A. Madison River Telephone is a privately owned limited liability company that is the  
37 ultimate parent company of Madison River and Gallatin River. Gallatin River is  
38 an incumbent local exchange carrier in Illinois. Madison River Capital, LLC  
39 recently converted to a C-corporation and renamed itself Madison River

40 Communications Corp. (“Madison River”). In connection with the proposed  
41 reorganization, Madison River will become the holding company and the ultimate  
42 parent of Gallatin River and the other companies that make up the Madison River  
43 family of companies. The Joint Applicants propose that Madison River become a  
44 publicly owned company through an initial public offering (“IPO”) of common  
45 stock.

46 **Q. Please address the effect of the proposed transaction on Gallatin River’s**  
47 **ability to raise necessary capital on reasonable terms.**

48 A. Gallatin River currently generates more cash than it requires for capital  
49 expenditures.<sup>1</sup> However, in the event Gallatin River needs additional funds to  
50 support its capital expenditures, it would have to rely on Madison River to access  
51 the capital markets since Madison River entered into a Credit Agreement on July  
52 29, 2005 (“2005 Credit Agreement”) that restricts the type and amount of debt  
53 that Gallatin River may incur.<sup>2</sup> Should Gallatin River require additional funds for  
54 capital expenditures, Madison River would draw on the \$75 million revolving line  
55 of credit associated with the 2005 Credit Agreement, and make that capital  
56 available to Gallatin River.

57 Excepting the \$75 million revolving credit facility, Madison River’s ability to raise  
58 capital and provide additional funds to Gallatin River is questionable given  
59 Madison River’s high degree of financial leverage. Since Madison River may

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<sup>1</sup> Company responses to Staff Data Requests JF-1.01 and JF-1.04.

<sup>2</sup> Company responses to Staff Data Requests JF-1.02 and JF-1.04.

60 draw upon the credit facility to support the operations of all its subsidiaries, a  
61 portion of the credit facility should be reserved for Gallatin River. Condition 6, as  
62 presented in Company witness Michael Skrivan's Direct Testimony, addresses  
63 this concern by requiring that an aggregate amount of funds equal to the higher  
64 of \$4 million or the currently approved capital expenditure budget of Gallatin  
65 River be kept available exclusively for Gallatin River. Thus, the proposed  
66 reorganization would not significantly impair Gallatin River's ability to raise  
67 *necessary* capital on reasonable terms.

68 **Q. Please address the effect of the proposed transaction on Gallatin River's**  
69 **ability to maintain a reasonable capital structure.**

70 A. Gallatin River currently has no debt outstanding.<sup>3</sup> Since the interest on debt is  
71 tax-deductible, it has a cost advantage over common equity. Thus, capital  
72 structures without any debt, like Gallatin River's capital structure, are not  
73 balanced from a cost standpoint. Further, the 2005 Credit Agreement prohibits  
74 Gallatin River from issuing debt.<sup>4</sup> However, when setting rates, the Commission  
75 typically uses the parent company's capital structure for subsidiaries like Gallatin  
76 River that rely on that parent company to supply external capital. Thus,  
77 consideration of the effect of the proposed reorganization on the parent  
78 company's ability to maintain a reasonable capital structure is appropriate in this  
79 case. Although the proportion of debt in Madison River's capital structure will  
80 remain very high after the proposed reorganization and recapitalization, the

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<sup>3</sup> Company Response to Staff Data Request JF-1.04.

<sup>4</sup> Company Responses to Staff Data Requests JF-1.02 and JF-1.04.

81 proportion of debt is expected to decline from the current level.<sup>5</sup> From this  
82 standpoint, the proposed reorganization can be deemed to enhance the ability of  
83 Madison River and Gallatin River, through Madison River, to achieve a balance  
84 capital structure.

85 **Q. Please describe the nature of your concerns regarding Madison River's**  
86 **financial strength as it pertains to Gallatin River's ability to provide**  
87 **reasonable and adequate service at reasonable cost.**

88 A. Madison River and Madison River Telephone have issuer credit ratings of B+  
89 from Standard & Poor's. The rating reflects the significant financial risks  
90 associated with the increasingly competitive landscape for wire line services,  
91 stagnant to declining growth in voice access lines, and a highly leveraged  
92 financial profile.<sup>6</sup> According to Standard & Poor's, a company with a B rating  
93 currently has the capacity to meet its financial commitments; however, adverse  
94 business, financial, or economic conditions will likely impair the company's  
95 capacity or willingness to meet its financial commitments.<sup>7</sup> Although the  
96 proposed recapitalization reduces the amount of debt at the Madison River level,  
97 the degree of its financial leverage will remain high. Therefore, even after its  
98 reorganization and recapitalization, Madison River's financial condition will not be  
99 sufficiently strong to eliminate concerns about its ability to meet its debt servicing

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<sup>5</sup> After the proposed transactions, the total amount of long-term debt outstanding will decrease from \$525 million to approximately \$435 million. (See Attachment 2 to the Joint Application, Form S-1 Registration Statement of the Securities and Exchange Commission, p. 48)

<sup>6</sup> Standard & Poor's Ratings Direct, *Research Summary: Madison River Communications Corp.*, October 23, 2006.

<sup>7</sup> Standard & Poor's, *Corporate Ratings Criteria 2006*, p. 12.

100 obligations without draining excessive amounts of cash from Gallatin River, which  
101 could be to the detriment of Gallatin River's service quality.

102 **Q. Does the Company's Condition 5 ensure that Gallatin River will maintain**  
103 **sufficient funds to support its operations?**

104 A. Yes. Should Gallatin River fail to pass the service quality test described in  
105 Condition 5, Gallatin River would be prohibited from paying dividends to Madison  
106 River or otherwise transferring cash to Madison River through loans, advances,  
107 investments or other means that would divert its moneys, property or other  
108 resources to any purpose that is not essentially or directly connected with the  
109 provision of non-competitive telecommunications service.<sup>8</sup> Condition 5 ensures  
110 that Gallatin River will retain sufficient funds to support its operations. Madison  
111 River would continue to have access to any funds that Gallatin River generates in  
112 excess of the amount needed to meet the service quality standards. Additionally,  
113 funds from the revolving credit facility and other sources would be reserved for  
114 Gallatin River on an annual basis in the event it needs additional funds.

115 **Q. Would this service quality condition be permanent?**

116 A. No. The service quality condition would be suspended upon Madison River's  
117 notification to the Chief Clerk of the Commission and Manager of the  
118 Commission's Finance Department that Madison River's issuer credit rating is  
119 raised to investment grade status. Currently, Madison River's issuer credit rating

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<sup>8</sup> Direct Testimony of Michael T. Skrivan, pp. 18-19.

120 is B+ from Standard & Poor's and B1 from Moody's Investors Service.<sup>9</sup>  
121 Investment grade status will be achieved when the issuer credit rating from  
122 Standard & Poor's is upgraded to BBB- or above and the rating from Moody's is  
123 upgraded to Baa3 or above.

124 **Q. Do you agree with the reporting requirements described on pages 19 and**  
125 **20 of Company witness Michael T. Skrivan's Direct Testimony?**

126 A. Yes, I agree with the two reporting requirements as put forth in Mr. Skrivan's  
127 testimony.

128 **Q. What is your conclusion?**

129 A. The first part of Section 7-204(b)(4) of the Act requires the Commission to find  
130 that the proposed reorganization will not impair the utility's ability to raise  
131 necessary capital on reasonable terms. In my judgment, under the proposed  
132 reorganization, Gallatin River will have little, if any need to access capital given  
133 that (a) Gallatin River currently generates sufficient cash to fund its capital  
134 expenditures; (b) Condition 5 would prevent Gallatin River from transferring that  
135 cash if it fails to meet the service quality standards described in that Condition;  
136 and (c) Condition 6 requires that funding be reserved through cash or credit  
137 agreements with external financial institutions for Gallatin River's capital  
138 expenditures.

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<sup>9</sup> Company Response to Staff Data Request JF-1.04.

139 Further, the reduction in the proportion of debt in Madison River's capital  
140 structure from its current level would enhance its ability to raise further capital on  
141 reasonable terms should the need arise. Nevertheless, it is unlikely that Madison  
142 River will achieve the degree of financial strength necessary to raise capital on  
143 reasonable terms under most capital market conditions until it further reduces the  
144 proportion of debt in its capital structure.

145 The second part of Section 7-204(b)(4) of the Act requires the Commission to  
146 find that the proposed reorganization will not impair the utility's ability to maintain  
147 a reasonable capital structure. I interpret "reasonable capital structure" as one  
148 that permits a utility to raise capital under most market conditions and results in a  
149 reasonable overall cost of capital. None of the Applicants currently maintain a  
150 reasonable capital structure. As stated previously, Gallatin River has no debt  
151 and the 2005 Credit Agreement limits Gallatin River's ability to issue debt that  
152 would balance its capital structure. When the Commission sets rates, it typically  
153 uses the parent company's capital structure to set rates for subsidiaries that rely  
154 upon that parent to supply external capital. The proposed reorganization and  
155 recapitalization would reduce the proportion of debt in Madison River's capital  
156 structure; although that reduction is unlikely to be sufficient for Madison River to  
157 attain investment grade credit ratings from either Standard & Poor's or Moody's.  
158 From this standpoint, the proposed reorganization cannot be deemed to result in  
159 a reasonable capital structure but can be deemed to enhance the ability of  
160 Madison River, and through Madison River, the ability of Gallatin River, to  
161 achieve a reasonable capital structure.

162 In summary, the proposed reorganization will not significantly impair Gallatin  
163 River's ability to raise necessary capital on reasonable terms or to maintain a  
164 reasonable capital structure, if the Companies comply with the conditions and  
165 reporting requirements set forth herein. Thus, I do not object to the proposed  
166 reorganization, subject to the conditions and reporting requirements described on  
167 pages 17 through 20 of Company witness Michael Skrivan's Direct Testimony.

168 **Q. Does this conclude your direct testimony?**

169 **A.** Yes, it does.

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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Madison River Telephone Company, LLC,	)	
And Gallatin River Communications, LLC	)	
	)	06-0683
Joint Application for approval of transfer of	)	
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COUNTY OF SANGAMON	)	
	)	ss:
STATE OF ILLINOIS	)	

**AFFIDAVIT OF JANIS FREETLY**

I, Janis Freetly, being duly sworn or affirmed, testify and state as follows:

1. My name is Janis Freetly and my business address is 527 East Capitol Avenue, Springfield, Illinois 62701. I am employed by the Illinois Commerce Commission as a Financial Analyst of the Finance Department of the Financial Analysis Division of the Illinois Commerce Commission. I make this affidavit in support of the admission of the testimony I caused to be pre-filed in this docket on or about November 14, 2006, into the record of the above-captioned proceeding.

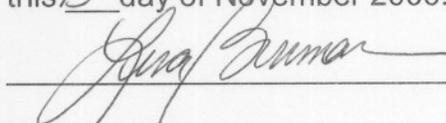
2. I have attached to this Affidavit as Staff Exhibit 2.0 a copy of the testimony that I caused to be pre-filed with the Clerk of the Commission on or about November 14, 2006. It consists of 9 pages of questions and answers that were prepared by me or under my direction and supervision.

3. If asked under oath or affirmation the questions posed in Staff Exhibit 2.0, I would provide the same answers as reflected in Staff Exhibit 2.0.

Further affiant sayeth not.

  
Janis Freetly

Sworn or affirmed before me  
this 13<sup>th</sup> day of November 2006.

  
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Notary Public

My Commission expires: 2007

