

DIRECT TESTIMONY  
OF  
SHEENA KIGHT-GARLISCH  
  
FINANCE DEPARTMENT  
FINANCIAL ANALYSIS DIVISION  
ILLINOIS COMMERCE COMMISSION

FAIRPOINT COMMUNICATIONS INC.,  
C-R TELEPHONE COMPANY D/B/A FAIRPOINT COMMUNICATIONS/  
C-R TELEPHONE COMPANY, THE EL PASO TELEPHONE COMPANY D/B/A  
FAIRPOINT COMMUNICATIONS/ THE EL PASO TELEPHONE COMPANY, AND  
ODIN TELEPHONE EXCHANGE, INC. D/B/A FAIRPOINT COMMUNICATIONS/  
ODIN TELEPHONE EXCHANGE, INC.

JOINT APPLICATION FOR APPROVAL OF A REORGANIZATION  
PURSUANT TO SECTIONS 7-203 AND 7-204 OF  
THE PUBLIC UTILITIES ACT

DOCKET NO. 10-0125

APRIL 14, 2010

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

2 A. My name is Sheena Kight-Garlich. My business address is 527 East  
3 Capitol Avenue, Springfield, Illinois 62701.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am employed by the Illinois Commerce Commission (“Commission”) as a  
6 Senior Financial Analyst in the Finance Department of the Financial  
7 Analysis Division.

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

9 A. In May of 1998, I received a Bachelor of Business degree in Finance and  
10 Marketing from Western Illinois University in Macomb, Illinois. I earned a  
11 Master of Business Administration degree, with a concentration in Finance,  
12 also at Western Illinois University in May of 2001. I have been employed by  
13 the Commission since January of 2001. I was promoted to Senior Financial  
14 Analyst on October 1, 2004.

15 **Q. Please state the purpose of your testimony in this proceeding.**

16 A. The purpose of my testimony is to present my evaluation of FairPoint  
17 Communications, Inc, C-R Telephone Company, The El Paso Telephone  
18 Company, and Odin Telephone Exchange, Inc.’s (collectively, the “Joint  
19 Applicants”) proposed reorganization pursuant to Section 7-204(b)(4) of the  
20 Illinois Public Utilities Act, 220 ILCS 5/1-101 *et seq.* (“Act”). The Joint  
21 Applicants filed an application for approval of the Reorganization Plan filed

22 in FairPoint Communications, Inc.'s ("FairPoint") Chapter 11 proceeding.  
23 My evaluation focuses on the financial implications of the proposed  
24 reorganization on C-R Telephone Company, The El Paso Telephone  
25 Company, and Odin Telephone Exchange, Inc.'s (jointly the "Illinois  
26 Utilities"), subsidiaries of FairPoint, ability to access the capital markets on  
27 reasonable terms.

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

30 A. In order to approve a proposed reorganization, Section 7-204(b)(4) of the  
31 Act requires the Commission to find that "the proposed reorganization will  
32 not significantly impair the utility's ability to raise necessary capital on  
33 reasonable terms or to maintain a reasonable capital structure."

34 **Q. Please summarize your findings.**

35 A. In my opinion, the proposed reorganization, subject to the conditions  
36 already imposed upon the Joint Applicants in addition to the conditions  
37 proposed in Exhibit 3.01 to this testimony, meets the requirements of  
38 Section 7-204(b)(4) of the Act.

39 **Q. Please describe the corporate relationship between the Illinois Utilities**  
40 **and FairPoint.**

41 A. The Illinois Utilities are wholly owned subsidiaries of FairPoint. The Illinois  
42 Utilities will remain wholly owned subsidiaries of FairPoint upon completion

43 of the proposed reorganization. However, FairPoint's common equity  
44 ownership interest will change. The proposed reorganization will reduce  
45 FairPoint's debt by converting approximately 63% of FairPoint's prepetition  
46 indebtedness into new common stock. After the reorganization, it is  
47 anticipated that no single shareholder would own a controlling interest of the  
48 post-reorganization FairPoint common stock.<sup>1</sup>

49 **Q. How do the Illinois Utilities raise capital?**

50 A. The Illinois Utilities have been able to satisfy all capital needs through cash  
51 generated from their operations. If the Illinois Utilities were to require  
52 additional capital from external sources, FairPoint would be responsible for  
53 raising all additional capital.<sup>2</sup>

54 **Q. Please describe how FairPoint's financial condition could impact the**  
55 **Illinois Utilities' ability to raise necessary capital on reasonable terms**  
56 **or to maintain a reasonable capital structure.**

57 A. Given FairPoint's bankruptcy filing, accessing the capital markets on  
58 reasonable terms would be problematic. Therefore, FairPoint is unlikely to  
59 be in a position to raise necessary capital on reasonable terms on behalf of  
60 the Illinois Utilities.

61 Further, although the Illinois Utilities may generate sufficient funds to  
62 support their operations, the proposed reorganization offers no guarantee  
63 that FairPoint would not draw upon those funds to support its obligations to

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<sup>1</sup> Joint Applicants' Exhibit 1.0, p. 7 lines 146-147.

<sup>2</sup> Joint Applicants' responses to Staff data requests SK 1.01-SK 1.03.

64 the detriment of the Illinois Utilities. Given the Illinois Utilities' reliance on  
65 internally generated cash flows to meet its capital requirements and  
66 FairPoint's poor financial condition, excessive remittance of dividends by the  
67 Illinois Utilities is not an implausible scenario. If the Illinois Utilities were to  
68 remit dividends in excess of its "free cash flow," their capital structures  
69 would weaken and could significantly impair their ability to raise  
70 replacement capital.<sup>3</sup>

71 **Q. Please describe the conditions that would place the proposed**  
72 **reorganization in compliance with the requirements of Section 7-**  
73 **204(b)(4) of the Act.**

74 A. The Joint Applicants should remain subject to the conditions imposed in ICC  
75 Docket Nos. 04-0299 and 07-0191 to protect the service quality and  
76 financial integrity of the utility subsidiaries. Included in those conditions are:  
77 (1) a restriction on dividend payments from the Illinois utilities to FairPoint if  
78 the Illinois Utilities fail to meet certain service quality standards (until such  
79 time as FairPoint attains an investment grade credit rating); (2) a  
80 requirement that FairPoint keep available, under its senior secured credit  
81 facility, an amount equal to the higher of \$1 million or the current collective  
82 capital expenditures budgets for all three Illinois Utilities for the Illinois  
83 Utilities' exclusive use; and (3) a requirement that the ceiling for capital  
84 expenditures set forth in FairPoint's credit facility agreement be no lower  
85 than 30% of FairPoint's annual EBITDA (Docket 04-0299 Conditions (6),

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<sup>3</sup> "Free cash flow" is the Company's net cash from operations, including changes in working capital, less construction expenditures, less maturing debt, less mandatory redemptions of debt and preferred stock, plus capitalized interest (AFUDC), plus any undistributed free cash flow.

86 (7), and (8), respectively). These conditions ensure that the financial needs  
87 of FairPoint shall be subordinate to those of its Illinois Utilities.

88 Also, I recommend the Commission impose three additional conditions on  
89 the Joint Applicants. Exhibit 3.01 to this testimony provides the conditions  
90 that the Illinois Utilities must agree to in order to be in compliance with the  
91 requirements of Section 7-204(b)(4) of the Act. Condition 1 addresses the  
92 terms for capital. It assures that in the event of a rate case the Illinois  
93 Utilities' cost of capital will be set commensurate to the risk of the Illinois  
94 Utilities exclusive of the effects of the proposed reorganization. Condition 2  
95 insulates the Illinois Utilities and its assets from the debts and obligations of  
96 their affiliates and further assures that rates will not reflect an increased cost  
97 of debt caused by the poor financial condition of its ultimate parent  
98 company. Condition 3 would facilitate monitoring of the Illinois Utilities' cash  
99 dividend payments to ensure that such payments do not impair the Illinois  
100 Utilities' capital.

101 Therefore, I recommend the Commission find that, with the continued  
102 imposition of Conditions (6), (7), and (8) from ICC Docket No. 04-0299 and  
103 the additional three conditions provided in Exhibit 3.01, the proposed  
104 reorganization will not significantly impair FairPoint's Illinois Utility  
105 subsidiaries' ability to raise necessary capital on reasonable terms or to  
106 maintain reasonable capital structures.

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

108 **A.** Yes, it does.

# **Exhibit 3.01**

### **Additional Conditions**

1. The cost of capital, as reflected in the Illinois Utilities' rates, shall not be adversely affected by the reorganization of FairPoint. Subsequent to the completion of the reorganization, the cost of capital for the Illinois Utilities in any future earnings analysis or rate base/rate of return case shall be set commensurate with the risk of the Illinois Utilities exclusive of any reorganization effects. Joint Applicants will not oppose, in either a regulatory proceeding or an appeal of a decision by the Commission, the application of the principle that the determination of the cost of capital shall be based solely on the risk attendant to the regulated operations of the Illinois Utilities. Any declines in the Illinois Utilities' financial condition caused by the reorganization or its announcement shall be quantified by the Joint Applicants in any future earnings analysis, or rate base/rate of return case and adjusted as if such declines did not occur. Joint Applicants shall use an imputed or hypothetical capital structure in any future earnings analysis, or rate base/rate of return rate case, if necessary to reflect the cost of capital for the Illinois Utilities without the effects of the reorganization.
  
2. Joint Applicants shall not allow any affiliate of the Illinois Utilities, including FairPoint, to obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the Illinois Utilities' assets. The financial arrangements of all affiliates of the Illinois Utilities, including FairPoint, are subject to the following restrictions:
  - a. Any indebtedness incurred by an affiliate, including FairPoint, will be without recourse to the Illinois Utilities.

- b. The Illinois Utilities shall not enter into any agreements under terms whereby the Illinois Utilities are obligated to commit funds in order to maintain the financial viability of an affiliate, including FairPoint.
- c. The Illinois Utilities shall not make any investment in an affiliate, including FairPoint, under circumstances in which the Illinois Utilities would be liable for the debts and/or liabilities of an affiliate incurred as a result of acts or omissions of an affiliate, including FairPoint.
- d. the Illinois Utilities shall not issue any security for the purpose of financing the acquisition, ownership, or operation of an affiliate, including FairPoint.
- e. The Illinois Utilities shall not assume any obligation or liability as guarantor, endorser, surety or otherwise with respect to any security of an affiliate, including FairPoint.
- f. The Illinois Utilities shall not pledge, mortgage or otherwise use as collateral any assets of any of the Illinois Utilities for the benefit of an affiliate, including FairPoint.
- g. Joint Applicants shall assure that rates to the regulated service customers of the Illinois Utilities are not increased by reason of the effects of credit rating declines or other adverse consequences caused directly by the reorganization.

- h. An affiliate, including FairPoint, shall not incur debt or pledge the stock of the Illinois Utilities, or any of them, in any manner that on the affiliate's default would permit a creditor to have recourse against the regulated assets of the Illinois Utilities.
- 3. Dividend transfers from the Illinois Utilities to affiliated companies during any calendar year shall be reported to the Illinois Commerce Commission ("Commission") within one week of the declaration of dividends.

"Dividend transfers" shall be defined as the amount of common dividends directly or indirectly remitted to affiliated companies.

Within 1 week following the declaration of dividends by any of the Illinois Utilities as specified above, the Illinois Utility shall submit a report of the declaration of dividends to the Manager of the Finance Department and the Office of the Chief Clerk. The Illinois Utilities shall also submit financial statements for the last 12-month period available at the time of the dividend declaration report to the Commission's Manager of the Finance Department

If FairPoint's senior debt is rated at least Baa2 by Moody's or its successors or BBB by Standard & Poor's or its successors, or if the Illinois Utilities are no longer owned or controlled by FairPoint, upon notification to the Office of the Chief Clerk and the Manager of the Finance Department, compliance with the dividend reporting requirement will not be necessary and the submission of financial statements may be suspended.