

ORIGINAL
FILED

1 SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY
2 AMENDED TESTIMONY OF WILLIAM B. KECK
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 DOCKET NO. 920260-TL
5 AUGUST 6, 1993
6

7 Q. PLEASE STATE YOUR NAME AND ADDRESS.
8

9 A. MY NAME IS WILLIAM B. KECK AND MY BUSINESS ADDRESS
10 IS 675 WEST PEACHTREE STREET, ATLANTA, GEORGIA
11 30375.
12

13 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?
14

15 A. I AM EMPLOYED BY BELLSOUTH TELECOMMUNICATIONS, INC.
16 D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY
17 (SOUTHERN BELL OR THE COMPANY). MY POSITION IS
18 DIRECTOR-CORPORATE FINANCE AND ASSISTANT TREASURER.
19

20 Q. WHAT ARE YOUR PRINCIPAL RESPONSIBILITIES IN THAT
21 POSITION?
22

23 A. I AM RESPONSIBLE FOR REGULATORY SUPPORT REGARDING
24 FINANCIAL MATTERS, INCLUDING CAPITAL MARKET
25 CONDITIONS, CAPITAL STRUCTURE AND COST OF CAPITAL

1 ISSUES. ADDITIONALLY, I ASSIST WITH THE LIAISON TO
2 THE CREDIT RATING AGENCIES AND THE INVESTMENT BANKS.
3 RELATIVE TO THE MANAGEMENT OF THE COMPANY'S
4 FINANCINGS, I ASSIST IN EVALUATING FINANCING
5 ALTERNATIVES AND NEW FINANCIAL PRODUCTS. I AM ALSO
6 RESPONSIBLE FOR DIRECTING THE COMPANY'S EFFORTS IN
7 THE AREA OF ECONOMIC DEVELOPMENT.

8

9 Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND BUSINESS
10 BACKGROUND.

11

12 A. I RECEIVED TWO BACHELOR OF ARTS DEGREES IN 1967 FROM
13 THE UNIVERSITY OF SOUTH FLORIDA - ONE IN MATHEMATICS
14 AND ONE IN MANAGEMENT. IN 1975, I RECEIVED A
15 MASTERS OF BUSINESS ADMINISTRATION WITH HONORS IN
16 MANAGEMENT SCIENCE FROM PACE UNIVERSITY IN NEW YORK
17 CITY. ADDITIONALLY, IN 1989, I SUCCESSFULLY
18 COMPLETED THE EXECUTIVE PROGRAM OF PROFESSIONAL
19 MANAGEMENT AT THE UNIVERSITY OF NORTH CAROLINA AT
20 CHAPEL HILL.

21

22 MY TELEPHONE CAREER, WHICH SPANS A PERIOD OF 27
23 YEARS, HAS BEEN CONCENTRATED PRIMARILY IN
24 FORECASTING, RATES AND TARIFFS, REVENUE
25 REQUIREMENTS, FINANCE AND TREASURY. I HAVE BEEN

1 INVOLVED IN TREASURY, COST OF CAPITAL AND THE
2 REGULATORY PROCESS AT COMPANY HEADQUARTERS FOR THE
3 PAST FIFTEEN YEARS. I WAS APPOINTED ASSISTANT
4 TREASURER OF THE COMPANY EFFECTIVE DECEMBER 1, 1984.

5
6 I AM A MEMBER OF THE NATIONAL SOCIETY OF RATE OF
7 RETURN ANALYSTS, THE FINANCIAL MANAGEMENT
8 ASSOCIATION, THE AMERICAN ECONOMIC DEVELOPMENT
9 COUNCIL, AND THE SOUTHERN INDUSTRIAL DEVELOPMENT
10 COUNCIL.

11

12 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS
13 PROCEEDING?

14

15 A. THE PURPOSE OF MY TESTIMONY IS TO PRESENT EVIDENCE
16 TO THIS COMMISSION AS TO THE APPROPRIATE CAPITAL
17 STRUCTURE AND DEBT COST RATES FOR SOUTHERN BELL.
18 ADDITIONALLY, I CALCULATE THE OVERALL COST OF
19 CAPITAL USING DR. BILLINGSLEY'S ESTIMATE OF THE
20 COMPANY'S COST OF EQUITY CAPITAL.

21

22 Q. HAVE YOU PREPARED EXHIBITS TO ACCOMPANY THIS
23 TESTIMONY?

24

25 A. YES, MY FOUR EXHIBITS SHOW THE COMPOSITION OF THE

1 CAPITAL STRUCTURE, THE CALCULATIONS OF THE DEBT COST
2 RATES, AND THE COMPUTATION OF THE COMPANY'S OVERALL
3 WEIGHTED COST OF CAPITAL.

4

5 Q. WHAT COMPONENTS ARE NEEDED TO DETERMINE A COMPANY'S
6 OVERALL COST OF CAPITAL?

7

8 A. THE OVERALL COST OF CAPITAL REFLECTS HOW A COMPANY
9 HAS FINANCED THE ASSETS USED IN ITS OPERATIONS AND
10 AT WHAT COST. THE CAPITAL STRUCTURE REFLECTS THE
11 RELATIVE PROPORTIONS OF DEBT AND EQUITY CAPITAL
12 UTILIZED. THE OVERALL COST OF CAPITAL IS DETERMINED
13 BY WEIGHTING THE CAPITAL COST RATES IN PROPORTION TO
14 THE USE OF THE VARIOUS TYPES OF CAPITAL.

15

16 THE COST RATE FOR A COMPANY'S DEBT IS EASILY
17 DETERMINED BECAUSE DEBT OBLIGATIONS ARE CONTRACTUAL
18 IN NATURE AND USUALLY SPECIFY UP FRONT THE RATE OF
19 INTEREST THAT MUST BE PAID TO THE LENDER.

20

21 THE COST RATE FOR SECURING COMMON EQUITY CAPITAL IS
22 MORE DIFFICULT TO DETERMINE. WHEN A COMMON EQUITY
23 INVESTOR MAKES AN INVESTMENT, HE OR SHE DOES NOT
24 HAVE AN ASSURED RETURN FROM THAT INVESTMENT. IN
25 ORDER FOR THE COMPANY TO BE CHOSEN BY THE INVESTOR,

1 THE COMPANY MUST OFFER THAT COMMON EQUITY INVESTOR
2 AN OPPORTUNITY TO EARN A RETURN ON HIS OR HER
3 INVESTMENT THAT IS ATTRACTIVE RELATIVE TO THE RISKS
4 ASSOCIATED WITH THAT INVESTMENT. SINCE THE
5 INVESTORS' REQUIRED RETURN CANNOT BE MEASURED
6 PRECISELY, IT MUST BE ESTIMATED USING SOUND JUDGMENT
7 AND APPROPRIATE FINANCIAL THEORIES, ANALYSES AND
8 METHODS. IN THIS PROCEEDING, DR. BILLINGSLEY'S
9 TESTIMONY ADDRESSES THE ISSUE OF THE COMPANY'S COST
10 OF COMMON EQUITY CAPITAL.

11

12 Q. YOU INDICATED EARLIER THAT THE CAPITAL STRUCTURE
13 REFLECTS THE RELATIVE PROPORTIONS OF DEBT AND COMMON
14 EQUITY CAPITAL UTILIZED TO FINANCE THE COMPANY'S
15 OPERATIONS. WHAT FACTORS INFLUENCE A COMPANY'S
16 MANAGEMENT DECISION REGARDING THE APPROPRIATE LEVEL
17 OF DEBT IN THE CAPITAL STRUCTURE?

18

19 A. THE MAJOR FACTOR AFFECTING THE DETERMINATION OF THE
20 ACCEPTABLE AMOUNT OF DEBT IN THE CAPITAL STRUCTURE
21 IS THE NATURE, MAGNITUDE AND DIRECTION OF THE
22 BUSINESS RISK FACING THE COMPANY. BUSINESS RISK CAN
23 BE DEFINED AS THE VARIABILITY OR VOLATILITY
24 ASSOCIATED WITH A COMPANY'S EARNINGS BEFORE INTEREST
25 AND TAXES. VARIABILITY OF EARNINGS COMES FROM MANY

1 SOURCES, BUT THE IMPACT IS FELT PRIMARILY ON THE
2 REVENUE STREAM.

3
4 THE SOURCES OF BUSINESS RISK ARE NUMEROUS AND
5 VARIED. NATIONAL AND INTERNATIONAL POLITICAL AND
6 ECONOMIC EVENTS THAT AFFECT THE GENERAL STATE OF THE
7 ECONOMY CAN ALSO IMPACT A COMPANY'S REVENUE AND
8 EXPENSES. INDUSTRY-WIDE FACTORS IMPACT THE PROFIT
9 STABILITY OF ITS PARTICIPANTS. HOWEVER, PROBABLY
10 THE MOST DIRECT AND SIGNIFICANT FACTORS THAT AFFECT
11 A COMPANY'S BUSINESS RISK AND ITS REVENUE STREAM ARE
12 (1) THE COMPETITION FACING THE COMPANY'S PRODUCTS
13 AND SERVICES AND (2) THE ELASTICITY OF DEMAND FOR
14 THOSE PRODUCTS AND SERVICES. ADDITIONALLY, NEW
15 TECHNOLOGIES AND INNOVATIONS CAN AFFECT NOT ONLY THE
16 REVENUE STREAM BUT ALSO THE INVESTMENT AND EXPENSES
17 ASSOCIATED WITH THE OPERATIONS OF A BUSINESS.

18
19 IN SUMMARY, THE MAJOR FACTOR AFFECTING THE
20 DETERMINATION OF THE APPROPRIATE CAPITAL STRUCTURE
21 IS THE NATURE, MAGNITUDE AND DIRECTION OF THE
22 BUSINESS RISK FACING A COMPANY.

23
24 Q. WHAT EVIDENCE HAS SOUTHERN BELL PRESENTED REGARDING
25 CHANGES IN THE LEVEL OF BUSINESS RISK FACING THE

1 COMPANY?

2

3 A. AN OVERVIEW OF THE SOURCES OF THE COMPANY'S BUSINESS
4 RISK AND THE INCREASING NATURE OF THAT RISK IS
5 PROVIDED TO THE COMMISSION IN THIS DOCKET IN THE
6 TESTIMONY OF COMPANY WITNESS DENTON. MR. DENTON
7 DISCUSSES HOW THE TELECOMMUNICATIONS INDUSTRY HAS
8 CHANGED SINCE 1988 IN THE AREAS OF TECHNOLOGY,
9 STRATEGIC ALLIANCES, AND POLICY DECISIONS AT THE FCC
10 AND BY THIS COMMISSION. HIS TESTIMONY DETAILS
11 SIGNIFICANT ACTIVITIES THAT HAVE OCCURRED IN EACH OF
12 THOSE AREAS AND HOW THEY ACCELERATE THE PACE OF
13 COMPETITION IN THE MARKETPLACE. THE IMPACT OF THESE
14 ACTIVITIES ON THE FUTURE DIRECTION AND MAGNITUDE OF
15 THE BUSINESS RISK FACING THE COMPANY IS READILY
16 APPARENT. THE COMPANY'S BUSINESS RISKS IN FLORIDA
17 ARE SIGNIFICANT AND REAL. IN SUMMARY, MR. DENTON'S
18 TESTIMONY PROVIDES EVIDENCE THAT THE COMPANY'S
19 BUSINESS RISKS HAVE INCREASED MATERIALLY IN RECENT
20 YEARS AND CAN REASONABLY BE EXPECTED TO CONTINUE TO
21 INCREASE IN THE FUTURE.

22

23 Q. WHAT EVIDENCE IS AVAILABLE TO INVESTORS REGARDING
24 THE CURRENT AND FUTURE LEVEL OF BUSINESS RISK FACING
25 SOUTHERN BELL?

1

2 A. CREDIT RATING AGENCIES AND SECURITY ANALYSTS, WHO
3 FOLLOW THE TELECOMMUNICATIONS INDUSTRY, HAVE BEEN
4 REPORTING FOR SOME TIME TO INVESTORS THAT THE
5 INDUSTRY IS IN A TRANSITION STAGE TOWARD MORE
6 COMPETITION AND THAT BUSINESS RISKS HAVE BEEN
7 INCREASING AND WILL, WITHOUT A DOUBT, CONTINUE TO
8 INCREASE.

9

10 FOR EXAMPLE, BACK IN 1985, STANDARD AND POOR'S (S&P)
11 STARTED DOCUMENTING THE INCREASED COMPETITION AND
12 BEGAN MAKING ITS FINANCIAL BENCHMARKS MORE STRINGENT
13 FOR THE LOCAL EXCHANGE COMPANIES. IT HAS SINCE MADE
14 ADDITIONAL REFINEMENTS TO ITS BENCHMARKS, ALL OF
15 WHICH ARE EVEN MORE STRINGENT, BASED ON THE
16 INCREASING LEVEL OF BUSINESS RISKS FACING THE
17 INDUSTRY PARTICIPANTS.

18

19 AS ILLUSTRATION, IN A SEPTEMBER 17, 1990 CREDITWEEK
20 ARTICLE THAT ANNOUNCED RISK CLASSIFICATION CHANGES
21 FOR THE LOCAL EXCHANGE COMPANIES, STANDARD AND
22 POOR'S SAID:

23

24 "BOTH TECHNOLOGICAL AND ECONOMIC COMPETITION
25 ARE NOW PRIME DRIVERS FOR TELECOMMUNICATIONS

1 BUSINESS RISK, AND THEIR EFFECT STEMS IN LARGE
2 MEASURE FROM THE NATURE OF THE BUSINESS.
3 TECHNOLOGICAL CHANGE HAS PROVIDED VIABLE
4 ALTERNATIVES THAT ARE FULLY COMPETITIVE IN
5 CERTAIN APPLICATIONS. THE GROWING DEPLOYMENT
6 OF COMPETITIVE COMMUNICATIONS SERVICES IN ALL
7 SECTORS OF THE TELECOMMUNICATIONS INDUSTRY WILL
8 CONTINUE TO PUSH BUSINESS RISK TO GREATER
9 HEIGHTS FOR THE MAJORITY OF INDUSTRY
10 PARTICIPANTS. ... GOING FORWARD, THE INDUSTRY'S
11 INEXORABLY GROWING EXPOSURE TO COMPETITION WILL
12 OCCUR WITH OR WITHOUT THE RECOGNITION OR
13 ADMISSION BY MANAGER AND REGULATOR."

14

15 Q. GIVEN THE INCREASED LEVEL OF BUSINESS RISK, SUCH AS
16 THAT WHICH IS NOW FACING THE TELECOMMUNICATIONS
17 INDUSTRY AND SOUTHERN BELL, HOW SHOULD A COMPANY
18 RESPOND TO THIS INCREASED BUSINESS RISK ENVIRONMENT?

19

20 A. WHEN THE REVENUE STREAMS BECOME VULNERABLE TO
21 COMPETITION AND, THEREFORE, MORE VOLATILE AND LESS
22 PREDICTABLE, THE COMPANY'S MANAGEMENT SHOULD RESPOND
23 BY OFFSETTING THIS INCREASED BUSINESS RISK BY
24 REDUCING ITS FINANCIAL RISKS. THIS WILL ALLOW IT TO
25 ACHIEVE THE LOWEST OVERALL COST OF CAPITAL. THIS IS

1 PRIMARILY ACCOMPLISHED BY LOWERING THE AMOUNT OF
2 DEBT IN THE CAPITAL STRUCTURE.

3

4 Q. ARE THERE ANY OTHER FACTORS, IN ADDITION TO
5 BALANCING BUSINESS RISK CONSIDERATIONS, THAT
6 INFLUENCE A COMPANY'S DECISION AS TO THE AMOUNT OF
7 DEBT IT MAINTAINS?

8

9 A. YES. THERE IS A CLEARLY UNDERSTOOD DIRECT
10 RELATIONSHIP BETWEEN THE RISK AND THE REQUIRED
11 INVESTOR RETURN ASSOCIATED WITH A FINANCIAL
12 INVESTMENT. THE GREATER THE RISKS TO THE INVESTOR
13 OF A PARTICULAR INVESTMENT, THE GREATER WILL BE THE
14 INVESTOR'S REQUIRED RETURN ON THAT INVESTMENT. DUE
15 TO THE CONTRACTUAL NATURE OF DEBT AND THE PRIORITY
16 OF CLAIMS A DEBT INVESTOR HAS ON THE COMPANY'S
17 ASSETS, DEBT CAPITAL REPRESENTS AN ADDITIONAL RISK
18 TO THE EQUITY HOLDER. THIS RESULTS IN THE GENERALLY
19 ACCEPTED IDEA THAT, FOR A GIVEN FIRM, ITS DEBT COSTS
20 LESS THAN ITS EQUITY.

21

22 THIS CAPITAL COST RELATIONSHIP INFLUENCES COMPANIES
23 WHEN THEY DETERMINE THEIR CAPITAL STRUCTURE. THEORY
24 AND COMMON SENSE SUGGEST THAT A COMPANY SHOULD
25 ENDEAVOR TO MINIMIZE ITS COST OF SECURING CAPITAL

1 JUST AS IT TRIES TO MINIMIZE ALL OF ITS OTHER COSTS
2 OF DOING BUSINESS. GIVEN THAT THE COST OF DEBT IS
3 LESS THAN THE COST OF EQUITY, THE USE OF DEBT
4 FINANCING IS APPROPRIATE AND BENEFICIAL, UP TO A
5 POINT, BECAUSE IT CAN LOWER THE COMPANY'S OVERALL
6 COST OF DOING BUSINESS. THE USE OF TOO MUCH DEBT,
7 HOWEVER, CAN DRASTICALLY RAISE A COMPANY'S OVERALL
8 COST OF CAPITAL. THIS IS DUE TO THE FACT THAT TOO
9 MUCH DEBT CAUSES A COMPANY'S COST OF BOTH DEBT AND
10 EQUITY TO RISE. IN THIS SITUATION, THE COMPANY'S
11 OVERALL FINANCIAL RISK WILL, IN EFFECT, INCREASE.
12 EVIDENCE OF THIS POINT IS ABUNDANT SINCE, OVER THE
13 PAST SEVERAL YEARS, MANY COMPANIES TOOK ON TOO MUCH
14 DEBT. THEIR REVENUE STREAMS WERE TOO VOLATILE OR
15 JUST NOT STRONG ENOUGH TO SUPPORT THE BURDENS OF
16 THAT DEBT AND THEY HAVE SUFFERED FINANCIALLY.

17
18 ANOTHER FACTOR THAT INFLUENCES THE CAPITAL STRUCTURE
19 DETERMINATION IS THE NEED FOR A LEVEL OF
20 CREDITWORTHINESS AND SUFFICIENT BORROWING MARGIN TO
21 ENABLE THE COMPANY TO OPERATE AS AN ONGOING ENTITY,
22 GIVEN ITS BUSINESS RISKS. SOUTHERN BELL MUST
23 COMPETE FOR FUNDS IN THE CAPITAL MARKETS WITH THE
24 MAJOR U.S. AND FOREIGN INDUSTRIAL AND UTILITY FIRMS.
25 HIGH QUALITY CREDIT RATINGS ENABLE THE COMPANY TO

1 ATTRACT CAPITAL. DUE TO THE CONTINUING GROWTH IN
2 SOUTHERN BELL'S SERVICE TERRITORY, THE COMPANY'S
3 LARGE CAPITAL REQUIREMENTS, AND ITS UTILITY
4 OBLIGATION TO SERVE RATEPAYERS, SOUTHERN BELL MUST
5 BE ABLE TO COMPETE FOR REASONABLY-PRICED FUNDS,
6 REGARDLESS OF CAPITAL MARKET CONDITIONS. HIGH
7 QUALITY CREDIT RATINGS FACILITATE THIS PROCESS.

8

9 Q. PLEASE BRIEFLY DESCRIBE THE COMPANY'S CAPITAL
10 STRUCTURE.

11

12 A. THE COMPANY'S DEBT RATIO HAS REMAINED FAIRLY STABLE
13 DURING THE PAST SEVERAL YEARS. AS REFLECTED IN THE
14 SURVEILLANCE REPORTS TO THIS COMMISSION, SOUTHERN
15 BELL'S AVERAGE DEBT RATIO HAS VARIED WITHIN A NARROW
16 RANGE:

17		DEBT
18	<u>YEAR</u>	<u>RATIO</u>
19	1988	37.27%
20	1989	37.54
21	1990	37.09
22	1991	37.27
23	1992 (BST)	37.38

24

25 AS SHOWN ON MY EXHIBIT WBK-1, FOR YEAR 1993, THE

1 AVERAGE DEBT RATIO IS EXPECTED TO BE 38.88%.

2

3 IN MY OPINION, GIVEN THE INCREASING BUSINESS RISK
4 FACING THE COMPANY AND THE RECENT RISE IN THE DEBT
5 RATIO, THE COMPANY'S OVERALL RISK, WHICH IS THE
6 COMBINATION OF THE BUSINESS AND FINANCIAL RISKS, HAS
7 INCREASED IN RECENT YEARS.

8

9 Q. WHAT HAS BEEN THE HISTORY OF THIS COMMISSION'S
10 REGULATORY PRACTICE REGARDING THE CAPITAL STRUCTURE
11 ISSUE AS APPLIED TO SOUTHERN BELL?

12

13 A. THIS COMMISSION, SINCE DIVESTITURE, HAS REGULATED
14 SOUTHERN BELL BASED ON THE COMPANY'S ACTUAL AVERAGE
15 CAPITAL STRUCTURE. THE CONTINUED USE OF THE
16 COMPANY'S ACTUAL CAPITAL STRUCTURE IN THIS
17 PROCEEDING IS APPROPRIATE. BY DOING SO, THE
18 COMMISSION IS RECOGNIZING THAT A COMPANY'S ACTUAL
19 CAPITAL STRUCTURE BEST REFLECTS THE REALITIES OF THE
20 COMPANY'S FINANCIAL SITUATION AND IT IS THAT CAPITAL
21 STRUCTURE WHICH IS READILY AVAILABLE TO THE
22 INVESTORS WHEN THEY ARE EVALUATING INVESTMENT
23 OPPORTUNITIES.

24

25 Q. WHAT IS YOUR RECOMMENDATION TO THIS COMMISSION

1 REGARDING THE APPROPRIATE CAPITAL STRUCTURE AND COST
2 RATES THAT SHOULD BE USED IN CONNECTION WITH THIS
3 PROCEEDING?

4

5 A. CONSISTENT WITH PAST PRACTICES OF THIS COMMISSION
6 AND THE CURRENT FINANCIAL REALITIES OF THE COMPANY,
7 I RECOMMEND THAT THE COMMISSION CONTINUE TO USE THE
8 COMPANY'S ACTUAL AVERAGE CAPITAL STRUCTURE AND THE
9 ACTUAL COST RATES.

10

11 BESIDES PAST COMMISSION PRACTICE, THERE ARE SEVERAL
12 OTHER REASONS WHY THE COMPANY'S ACTUAL CAPITAL
13 STRUCTURE IS APPROPRIATE. AGAIN, INVESTORS ASSESS
14 THE COMPANY'S FINANCIAL RISK BASED ON ITS ACTUAL
15 CAPITAL STRUCTURE, AS IT IS REFLECTED IN ITS
16 PUBLISHED FINANCIAL STATEMENTS. SECOND, IN A
17 REGULATORY CONTEXT, THE USE OF A HYPOTHETICAL,
18 RATHER THAN AN ACTUAL CAPITAL STRUCTURE, CREATES A
19 SITUATION WHERE THE FINANCIAL RESULTS OF RATEMAKING
20 WILL NOT, IN FACT, BE ACHIEVED BY THE INVESTORS.

21

22 AS ILLUSTRATION OF THIS LAST POINT, LET ME PROVIDE
23 AN EXAMPLE. SUPPOSE THAT THE UTILITY HAS A CAPITAL
24 STRUCTURE OF 40% DEBT AND 60% EQUITY. IF ITS DEBT
25 COST RATE WAS 8% AND ITS COST OF EQUITY WAS 14%, ITS

1 OVERALL COST OF CAPITAL WOULD BE 11.6%. IF THE
2 COMPANY'S RATE BASE WAS \$1,000 AND IT HAD A TAX RATE
3 OF 40%, THIS WOULD MEAN THAT THE REVENUE
4 REQUIREMENTS NEEDED TO SATISFY THE INVESTORS'
5 REQUIREMENTS WOULD BE \$172.00.

6
7 RATE BASE x [{(ROE x EQUITY RATIO)/(1 - TAX RATE)} +
8 (DEBT COST x DEBT RATIO)]

9
10 1000 x [{(.14 x .60)/(1 - .40)} + (.08 x .40)]

11
12 NOW SUPPOSE THAT THE COMMISSION WAS TO AUTHORIZE THE
13 COMPANY'S COST RATES BUT DECIDED TO ADOPT A
14 HYPOTHETICAL CAPITAL STRUCTURE OF 50% DEBT AND 50%
15 EQUITY. THIS REGULATORY DECISION WOULD RESULT IN
16 RATES DESIGNED TO PRODUCE ONLY \$156.67 IN ADDITIONAL
17 REVENUES. FROM THIS EXAMPLE, YOU CAN SEE THAT A
18 \$15.33 SHORTFALL WAS CREATED FROM THE INVESTORS'
19 REQUIRED RETURN TO THE ADDITIONAL REVENUES
20 AUTHORIZED BECAUSE A HYPOTHETICAL CAPITAL STRUCTURE
21 WAS USED. THIS SHORTFALL IS WHAT I WAS REFERRING TO
22 WHEN I INDICATED THAT THE USE OF A HYPOTHETICAL,
23 RATHER THAN AN ACTUAL CAPITAL STRUCTURE, CREATES A
24 SITUATION WHERE THE FINANCIAL RESULTS OF RATEMAKING
25 WILL NOT BE ACHIEVED BY THE INVESTORS.

1

2 Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT THE POSSIBLE
3 USE OF CAPITAL STRUCTURE DIFFERENT FROM THE
4 COMPANY'S ACTUAL CAPITAL STRUCTURE?

5

6 A. YES. THE SIGNAL THAT WOULD BE SENT TO INVESTORS BY
7 THE USE OF A HYPOTHETICAL CAPITAL STRUCTURE WOULD BE
8 NEGATIVE, COULD ULTIMATELY CAUSE FINANCIAL HARM TO
9 THE COMPANY, AND COULD INCREASE THE COST OF
10 TELECOMMUNICATIONS SERVICES. THIS CONCERN WAS
11 EXPLICITLY RECOGNIZED BY THIS COMMISSION, IN ORDER
12 20162 IN SOUTHERN BELL DOCKET NO. 880069-TL, DATED
13 OCTOBER 13, 1988, WHEN IT STATED THAT

14

15 "IMPUTING A LOWER EQUITY RATIO REDUCES THE
16 COMPANY'S ABILITY TO EARN ON ITS ACTUAL CAPITAL
17 STRUCTURE. IMPUTING A LOWER EQUITY RATIO COULD
18 ALSO ADVERSELY AFFECT THE COMPANY'S ABILITY TO
19 REACT TO CHANGES IN ITS OPERATING ENVIRONMENT
20 AND COULD POSSIBLY RESULT IN A LOWER BOND
21 RATING FOR THE COMPANY."

22

23 Q. WHAT IS THE COMPOSITION OF THE CAPITAL STRUCTURE
24 THAT THE COMPANY IS RECOMMENDING?

25

1 A. MY EXHIBIT WBK-1 REFLECTS THE APPLICATION OF THE
2 COMPANY'S AVERAGE CAPITAL STRUCTURE RATIOS TO THE
3 FLORIDA INTRASTATE CAPITAL FOR YEAR 1993.

4
5 AT THE TOP OF THAT EXHIBIT IS SHOWN THE COMPANY'S
6 AVERAGE CAPITAL STRUCTURE FOR 1993. THE LOWER
7 PORTION OF THAT EXHIBIT REFLECTS THE FLORIDA
8 INTRASTATE AVERAGE CAPITAL STRUCTURE FOR 1993 THAT
9 IS RECONCILED WITH THE FLORIDA INTRASTATE RATE BASE
10 PRESENTED IN THE TESTIMONY OF COMPANY WITNESS REID.

11
12 Q. PLEASE EXPLAIN HOW THE COMPANY'S AVERAGE 1993
13 CAPITAL STRUCTURE, SHOWN ON THE TOP OF THAT EXHIBIT,
14 WAS ESTIMATED.

15
16 A. FOR THE MONTHS UP TO AND INCLUDING APRIL, 1993,
17 ACTUAL COMPANY DATA WAS USED. THE MONTHLY DATA FOR
18 MAY THROUGH DECEMBER HAD TO BE ESTIMATED. THE
19 FOLLOWING APPROACH WAS USED FOR THOSE MONTHS:

20
21 FOR LONG-TERM DEBT

22
23 THE LEVEL OF FUNDED DEBT WAS ESTIMATED MONTHLY
24 RECOGNIZING THE TWO REFINANCINGS THAT WERE
25 INITIATED IN MAY AND THE ONE INITIATED IN JUNE.

1 NO OTHER REFINANCINGS WERE ASSUMED TO OCCUR IN
2 1993. THE AVERAGE LEVEL OF OTHER LONG-TERM
3 DEBT AND CAPITALIZED LEASES FOR THE PERIOD
4 JANUARY THROUGH APRIL WAS USED AS THE LEVEL FOR
5 EACH MONTH, MAY THROUGH DECEMBER.

6

7 FOR SHORT-TERM DEBT

8

9 THE AVERAGE LEVEL OF COMMERCIAL PAPER FOR THE
10 PERIOD JANUARY THROUGH APRIL WAS USED AS THE
11 LEVEL FOR EACH MONTH, MAY THROUGH DECEMBER.
12 THE ESTIMATED LEVEL OF COMMERCIAL PAPER FOR
13 JUNE THROUGH DECEMBER, HOWEVER, WAS ADJUSTED
14 SLIGHTLY DOWNWARD TO REFLECT A \$19 MILLION
15 REDUCTION IN JUNE CAUSED BY THE \$500 MILLION
16 EUROBOND REFINANCING. THE AVERAGE LEVEL OF
17 SHORT-TERM CAPITALIZED LEASES FOR THE PERIOD
18 JANUARY THROUGH APRIL WAS USED AS THE LEVEL FOR
19 EACH MONTH, MAY THROUGH DECEMBER.

20

21 FOR COMMON EQUITY

22

23 THE AVERAGE LEVEL OF COMMON EQUITY FOR THE
24 PERIOD JANUARY THROUGH APRIL WAS USED AS THE
25 LEVEL FOR EACH MONTH, MAY THROUGH DECEMBER.

1

2 USING THE APPROACH JUST DESCRIBED RESULTS IN AN
3 ESTIMATED CAPITAL STRUCTURE WHICH IS SLIGHTLY
4 DIFFERENT FROM THE COMPANY'S 1993 COMMITMENT VIEW.
5 THE CAPITAL STRUCTURE SHOWN ON THE TOP OF MY EXHIBIT
6 WBK-1 HAS A SLIGHTLY HIGHER DEBT RATIO PRIMARILY
7 BECAUSE THE COMMITMENT VIEW DOES NOT REFLECT THE
8 REFINANCING THAT HAVE OCCURRED IN 1993.

9

10 THE COMPANY INTENDS TO PROVIDE THIS COMMISSION WITH
11 AN UPDATE OF THE COMPANY'S CAPITAL STRUCTURE AND
12 DEBT COST RATES LATER IN THE YEAR. THAT UPDATE WILL
13 INCLUDE SEVERAL MORE MONTHS OF ACTUAL 1993 DATA.

14

15 Q. WHAT ARE THE COST RATES THAT THE COMPANY IS
16 RECOMMENDING?

17

18 A. THE AVERAGE COST RATE FOR THE COMPANY'S LONG-TERM
19 DEBT FOR THE YEAR 1993 IS EXPECTED TO BE 8.07%. THE
20 CALCULATION OF THIS COST RATE IS SHOWN AT THE TOP OF
21 EXHIBIT WBK-2. IN ARRIVING AT THAT FIGURE, AN
22 AVERAGE COST RATE FOR FUNDED DEBT WAS ESTIMATED (1)
23 RECOGNIZING THE FEBRUARY REFINANCING, THE TWO
24 REFINANCINGS THAT WERE INITIATED IN MAY, AND THE
25 REFINANCING THAT WAS INITIATED IN JUNE, AND (2)

1 ASSUMING NO ADDITIONAL REFINANCINGS DURING 1993.
2 THIS IS THE FIGURE THAT THE COMMISSION WOULD
3 NORMALLY USE.

4
5 HOWEVER, FOR THIS PARTICULAR PROCEEDING, THE COMPANY
6 RECOMMENDS THAT THE COMMISSION USE A DIFFERENT COST
7 RATE FOR LONG-TERM DEBT. SINCE THE BEGINNING OF
8 1993, THE COMPANY HAS REFINANCED \$1.76 BILLION
9 (NEARLY 28%) OF ITS DEBT. THESE REFINANCINGS HAVE
10 REDUCED THE COMPANY'S COST OF FUNDED DEBT FROM 8.48%
11 TO AN ESTIMATED 7.75% AS OF THE END OF JULY. IN
12 RECOGNITION OF THESE EVENTS, I HAVE PROVIDED THE
13 THE CALCULATION OF THE COMPANY'S ESTIMATED COST FOR
14 LONG-TERM DEBT AS OF JULY 31, 1993 AT THE BOTTOM OF
15 EXHIBIT WBK-2. THAT COST RATE IS 7.77%. THIS IS
16 THE COST RATE THAT I WILL USE FOR DETERMINING THE
17 OVERALL COST OF CAPITAL BECAUSE IT REFLECTS THE
18 COMPANY'S GOING-FORWARD ACTUAL INTEREST OBLIGATIONS.

19
20 THE AVERAGE COST RATE FOR THE COMPANY'S SHORT-TERM
21 DEBT FOR THE YEAR 1993 IS EXPECTED TO BE 3.30%. THE
22 CALCULATION OF THIS COST RATE IS SHOWN ON EXHIBIT
23 WBK-3. ACTUAL COST RATES WERE USED FOR MONTHS UP TO
24 AND INCLUDING APRIL. THE AVERAGE COST RATE FOR THE
25 PERIOD FROM JANUARY THROUGH APRIL WAS USED AS THE

1 COST RATE FOR THE MONTHS, MAY THROUGH DECEMBER.
2
3 THE COST RATES FOR BOTH THE CUSTOMER DEPOSITS AND
4 INVESTMENT TAX CREDITS WERE COMPUTED ACCORDING TO
5 COMMISSION RULES AND PROCEDURES. THE UNDERLYING
6 DATA FOR CUSTOMER DEPOSITS WAS PROVIDED IN THE
7 MINIMUM FILING REQUIREMENTS (MFR), FILED ON JULY 2,
8 1993.

9
10 THE TESTIMONY AND EXHIBITS OF DR. BILLINGSLEY
11 PROVIDE EVIDENCE THAT THE COMPANY'S CURRENT COST OF
12 EQUITY IS IN THE RANGE OF 13.90% TO 14.18%. THE
13 MIDPOINT OF THIS RANGE IS APPROXIMATELY 14.0%, WHICH
14 IS STILL WITHIN THE PARAMETERS OF THE EXISTING
15 INCENTIVE SHARING PLAN.

16
17 Q. WHAT IS THE COMPANY'S OVERALL COST OF CAPITAL?

18
19 A. ON EXHIBIT WBK-4, I HAVE COMPUTED THE COMPANY'S
20 OVERALL COST OF CAPITAL TO BE 9.28% BY COMBINING THE
21 INDICATED 14.0% MIDPOINT OF THE RANGE OF COST OF
22 EQUITY WITH THE APPROPRIATE CAPITAL STRUCTURE
23 COMPONENTS AND THE VARIOUS OTHER COST COMPONENTS.

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1 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

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3 A. YES, IT DOES.

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BELLSOUTH TELECOMMUNICATIONS, INC.
 (D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY)
 AVERAGE CAPITAL STRUCTURE
Estimated Average 12 Months Ending 12-31-93

	Amount (\$000)	Percent of Total
Long-Term Debt	\$ 6,185,139	33.19%
Short-Term Debt	1,061,015	5.69
Common Equity	11,387,442	61.12
TOTAL CAPITAL	\$18,633,596	100.00%

ADJUSTED 1993 FLORIDA INTRASTATE CAPITAL STRUCTURE

	Amount (\$000)	Percent of Total
Long-Term Debt	\$ 1,053,771	25.97%
Short-Term Debt	180,655	4.45
Common Equity	1,940,538	47.83
Preferred Stock	0	0.00
Customer Deposits	55,182	1.36
Cost Free Capital	723,093	17.82
Investment Tax Credits	104,223	2.57
TOTAL CAPITAL	\$ 4,057,462	100.00%

BELLSOUTH TELECOMMUNICATIONS, INC.
 (D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY)

AVERAGE COST RATE FOR LONG-TERM DEBT
Estimated Average 12 Months Ending 12-31-93

<u>Long-Term Debt</u>	<u>Amount (\$000)</u>	<u>Annual Interest</u>	<u>Cost Rate</u>
Funded Debt	\$ 6,155,843	\$ 495,297,000	8.05%
Other Long-Term Debt	1,325	118,601	8.95
Capital Leases	27,971	3,489,078	12.47
	<hr/>	<hr/>	<hr/>
TOTAL LONG-TERM DEBT	\$ 6,185,139	\$ 498,904,679	8.07%

COST FOR LONG-TERM DEBT
Estimated as of JULY 31, 1993

<u>Long-Term Debt</u>	<u>Amount (\$000)</u>	<u>Annual Interest</u>	<u>Cost Rate</u>
Funded Debt	\$ 6,223,604	\$ 482,090,000	7.75%
Other Long-Term Debt	1,321	118,240	8.95
Capital Leases	27,918	3,522,751	12.62
	<hr/>	<hr/>	<hr/>
TOTAL LONG-TERM DEBT	\$ 6,252,843	\$ 485,730,991	7.77%

FPSC EXHIBIT NUMBER _____
FPSC DOCKET 920260-TL
KECK EXHIBIT WBK-3
AVERAGE COST RATE FOR
SHORT-TERM DEBT
PAGE 1 OF 1

BELLSOUTH TELECOMMUNICATIONS, INC.
(D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY)
AVERAGE COST RATE FOR SHORT-TERM DEBT
Estimated Average 12 Months Ending 12-31-93

<u>Short-Term Debt</u>	<u>Amount (\$000)</u>	<u>Annual Interest</u>	<u>Cost Rate</u>
Commercial Paper	\$ 1,051,359	\$ 33,827,127	3.22%
Capital Leases	9,656	1,204,541	12.47
TOTAL SHORT-TERM DEBT	\$ 1,061,015	\$ 35,031,668	3.30%

FPSC EXHIBIT NUMBER _____
FPSC DOCKET 920260-TL
KECK EXHIBIT WBK-4
OVERALL COST OF CAPITAL
PAGE 1 OF 1

BELLSOUTH TELECOMMUNICATIONS, INC.
(D/B/A SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY)
OVERALL COST OF CAPITAL
Estimated Average 12 Months Ending 12-31-93

	Amount (\$000)	Percent of Total	Cost Rate	Wtd. Cost
Long-Term Debt	\$ 1,053,771	25.97%	7.77%	2.02%
Short-Term Debt	180,655	4.45	3.30	.15
Common Equity	1,940,538	47.83	14.00	6.70
Preferred Stock	0	0.00	0.00	0.00
Customer Deposits	55,182	1.36	8.23	.11
Cost Free Capital	723,093	17.82	0.00	0.00
Investment Tax Credits	104,223	2.57	11.81	.30
TOTAL CAPITAL	\$ 4,057,462	100.00%		9.28%