

M E M O R A N D U M

April 4, 2002

TO: DIVISION OF THE COMMISSION CLERK AND ADMINISTRATIVE SERVICES

FROM: OFFICE OF THE GENERAL COUNSEL (FUDGE) *off*

RE: DOCKET NO. 990649B-TP - INVESTIGATION INTO PRICING OF UNBUNDLED NETWORK ELEMENTS (SPRINT/VERIZON TRACK). CORRECTION OF WITNESS DAVID DRAPER TESTIMONY

Attached is a MEMORANDUM, with attachments, to be issued in the above-referenced docket. (Number of pages in memorandum - 3)

DATE MEMORANDUM SENT ELECTRONICALLY TO CCA 4/4/02

JKF/anc
Attachment
I:990649/letcor.jkf

DOCUMENT NUMBER-DATE
03849 APR-5 8
FPSC-COMMISSION CLERK



Public Service Commission
-M-E-M-O-R-A-N-D-U-M-

DATE: APRIL 4, 2002
TO: ALL PARTIES OF RECORD
FROM: JASON K. FUDGE, SENIOR ATTORNEY *JKF*
RE: DOCKET NO. 990649B-TP - INVESTIGATION INTO PRICING OF UNBUNDLED NETWORK ELEMENTS (SPRINT/VERIZON TRACK). CORRECTION OF WITNESS DAVID DRAPER TESTIMONY

After prefilng his testimony, Staff witness David Draper found a miscalculation in his testimony. Accordingly, Staff witness David Draper's testimony should be corrected as follows:

On page 8, line 6, the sentence "The allowance for issuance costs added approximately 15 basis points to the overall cost of equity." should read as follows: "The allowance for issuance costs added approximately 4 basis points (rounded) to the overall cost of equity."

This change will affect the overall cost of equity and WACC for both Verizon-Florida and Sprint-Florida as reflected in revised Exhibits DJD-5 & DJD-6 (attached).

JKF/anc

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FPSC-COMMISSION CLERK

REVISED EXHIBIT DJD-5

CAPITAL ASSET PRICING MODEL COST OF EQUITY

CAPM Analysis Formula

$$K = RF + \text{Beta}(\text{MR} - \text{RF}) + \text{FC}$$

$$K = \text{Investor's required rate of return}$$

$$\text{RF} = \text{Risk-free rate (Blue Chip forecast for 30-year Treasury bond)}$$

$$\text{Beta} = \text{Measure of systematic risk}$$

$$\text{MR} = \text{Market return}$$

$$\text{FC} = \text{Flotation cost adjustment}$$

$$\text{Telecommunications CAPM} = 5.4\% + 1.02(10.87\% - 5.4\%) + .04\% = 11.02\%$$

Source: Blue Chip Financial Forecasts, December 1, 2001
Value Line Investment Survey for Windows, November 2001 edition

REVISED EXHIBIT DJD-6

DOCKET NO. 990649B-TP
INVESTIGATION INTO PRICING
UNBUNDLED NETWORK ELEMENTS
WITNESS: DAVID J. DRAPER

FORWARD-LOOKING WEIGHTED AVERAGE COST OF CAPITAL
SPRINT FLORIDA

	<u>Ratio</u>	<u>Cost Rate</u>	<u>WACC</u>
DEBT	40%	7.43%	2.97%
COMMON EQUITY	60%	11.49%	<u>6.89%</u>
			9.86%

VERIZON FLORIDA

	<u>Ratio</u>	<u>Cost Rate</u>	<u>WACC</u>
DEBT	40%	7.22%	2.89%
COMMON EQUITY	60%	11.24%	<u>6.74%</u>
			9.63%

CAPM Results:	11.02%
DCF Results:	<u>11.45%</u>
Average ROE Results:	<u>11.24%</u>

Verizon Florida Cost of Debt:

Long-term Debt: $5.00\% + 2.84\% = 7.84\% \times 75\% = 5.88\%$

Short-term Debt: Forecasted Prime Rate= $5.36\% \times 25\% = 1.34\%$

Weighted Average Cost of Debt: 7.22%

Sprint Florida Cost of Debt:

Long-term Debt: $5.00\% + 3.12\% = 8.12\% \times 75\% = 6.09\%$

Short-term Debt: Forecasted Prime Rate= $5.36\% \times 25\% = 1.34\%$

Weighted Average Cost of Debt: 7.43%