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ORIGINAL
FILE COPY

October 1, 1993

Mr. Steve C. Tribble
Director, Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301

RE: Docket No. 920260-TL

Dear Mr. Tribble:

Enclosed for filing in the above-referenced docket, please find an original and fifteen copies of the updated direct testimony of William B. Keck, Nancy H. Sims and Walter S. Reid for Southern Bell Telephone and Telegraph Company. Please note that the updated testimony of Messrs. Keck and Sims should completely replace their earlier testimony. In addition, all of Mr. Keck's exhibits have been replaced. Three of Mrs. Sims' have been replaced as well and one exhibit is being updated.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served on the parties shown on the attached Certificate of Service.

ACK _____
AFA 5 _____
APP _____
CAF _____
CMT _____

Sincerely,

R. Douglas Lackey
R. Douglas Lackey

CT Enclosures

cc: 1 All Parties of Record
1 A. M. Lombardo
1 H. R. Anthony
1 *dis 46*

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W/S _____
OTH _____
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1 *Reid*
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Sims
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Keck
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CERTIFICATE OF SERVICE

Docket No. 920260-TL

Docket No. 900960-TL

Docket No. 910163-TL

Docket No. 910727-TL

I HEREBY CERTIFY that a copy of the foregoing has been
furnished by United States Mail this 1st day of October, 1993 to:

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COPY

1 SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY
2 UPDATED TESTIMONY OF WILLIAM B. KECK
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 DOCKET NO. 920260-TL
5 OCTOBER 1, 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. HAVE YOU FILED DIRECT TESTIMONY IN THIS DOCKET?

13

14 A. YES. I FILED DIRECT TESTIMONY REGARDING THE
15 APPROPRIATE CAPITAL STRUCTURE AND DEBT COST RATES
16 FOR SOUTHERN BELL. I ALSO CALCULATED THE OVERALL
17 COST OF CAPITAL USING DR. BILLINGSLEY'S ESTIMATE OF
18 THE COMPANY'S COST OF EQUITY CAPITAL.

19

20 Q. WHAT IS THE PURPOSE OF YOUR UPDATED TESTIMONY?

21

22 A. THE PURPOSE OF MY UPDATED TESTIMONY IS TO PROVIDE AN
23 UPDATED ESTIMATE OF THE COMPANY'S AVERAGE 1993
24 CAPITAL STRUCTURE AND ITS DEBT COST RATES. THE
25 UPDATED ESTIMATE PRESENTED IN THIS TESTIMONY

1 CONTAINS THREE ADDITIONAL MONTHS OF ACTUAL COMPANY
2 DATA AND INCLUDES THE EFFECTS OF AN ADDITIONAL DEBT
3 REFINANCING UNDERTAKEN BY THE COMPANY SINCE THE JULY
4 2, 1993 FILING OF MY DIRECT TESTIMONY.

5

6 ADDITIONALLY, AS I DID IN MY DIRECT TESTIMONY, I
7 ALSO CALCULATE THE OVERALL COST OF CAPITAL USING DR.
8 BILLINGSLEY'S ESTIMATE OF THE COMPANY'S COST OF
9 EQUITY CAPITAL.

10

11 Q. HAVE YOU PREPARED EXHIBITS TO ACCOMPANY THIS UPDATED
12 TESTIMONY?

13

14 A. YES, I UPDATED MY FOUR ORIGINAL EXHIBITS TO SHOW THE
15 REVISED COMPOSITION OF THE CAPITAL STRUCTURE, THE
16 REVISED CALCULATIONS OF THE DEBT COST RATES, AND THE
17 UPDATED COMPUTATION OF THE COMPANY'S OVERALL
18 WEIGHTED COST OF CAPITAL.

19

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

22

23 A. THE OVERALL COST OF CAPITAL REFLECTS HOW A COMPANY
24 HAS FINANCED THE ASSETS USED IN ITS OPERATIONS AND
25 AT WHAT COST. THE CAPITAL STRUCTURE REFLECTS THE

1 RELATIVE PROPORTIONS OF DEBT AND EQUITY CAPITAL
2 UTILIZED. THE OVERALL COST OF CAPITAL IS DETERMINED
3 BY WEIGHTING THE CAPITAL COST RATES IN PROPORTION TO
4 THE USE OF THE VARIOUS TYPES OF CAPITAL.
5
6 THE COST RATE FOR A COMPANY'S DEBT IS EASILY
7 DETERMINED BECAUSE DEBT OBLIGATIONS ARE CONTRACTUAL
8 IN NATURE AND USUALLY SPECIFY UP FRONT THE RATE OF
9 INTEREST THAT MUST BE PAID TO THE LENDER.
10
11 THE COST RATE FOR SECURING COMMON EQUITY CAPITAL IS
12 MORE DIFFICULT TO DETERMINE. WHEN A COMMON EQUITY
13 INVESTOR MAKES AN INVESTMENT, HE OR SHE DOES NOT
14 HAVE AN ASSURED RETURN FROM THAT INVESTMENT. IN
15 ORDER FOR THE COMPANY TO BE CHOSEN BY THE INVESTOR,
16 THE COMPANY MUST OFFER THAT COMMON EQUITY INVESTOR
17 AN OPPORTUNITY TO EARN A RETURN ON HIS OR HER
18 INVESTMENT THAT IS ATTRACTIVE RELATIVE TO THE RISKS
19 ASSOCIATED WITH THAT INVESTMENT. SINCE THE
20 INVESTORS' REQUIRED RETURN CANNOT BE MEASURED
21 PRECISELY, IT MUST BE ESTIMATED USING SOUND JUDGMENT
22 AND APPROPRIATE FINANCIAL THEORIES, ANALYSES AND
23 METHODS. IN THIS PROCEEDING, DR. BILLINGSLEY'S
24 TESTIMONY ADDRESSES THE ISSUE OF THE COMPANY'S COST
25 OF COMMON EQUITY CAPITAL.

1

2 Q. YOU INDICATED EARLIER THAT THE CAPITAL STRUCTURE
3 REFLECTS THE RELATIVE PROPORTIONS OF DEBT AND COMMON
4 EQUITY CAPITAL UTILIZED TO FINANCE THE COMPANY'S
5 OPERATIONS. WHAT FACTORS INFLUENCE A COMPANY'S
6 MANAGEMENT DECISION REGARDING THE APPROPRIATE LEVEL
7 OF DEBT IN THE CAPITAL STRUCTURE?

8

9 A. THE MAJOR FACTOR AFFECTING THE DETERMINATION OF THE
10 ACCEPTABLE AMOUNT OF DEBT IN THE CAPITAL STRUCTURE
11 IS THE NATURE, MAGNITUDE AND DIRECTION OF THE
12 BUSINESS RISK FACING THE COMPANY. BUSINESS RISK CAN
13 BE DEFINED AS THE VARIABILITY OR VOLATILITY
14 ASSOCIATED WITH A COMPANY'S EARNINGS BEFORE INTEREST
15 AND TAXES. VARIABILITY OF EARNINGS COMES FROM MANY
16 SOURCES, BUT THE IMPACT IS FELT PRIMARILY ON THE
17 REVENUE STREAM.

18

19 THE SOURCES OF BUSINESS RISK ARE NUMEROUS AND
20 VARIED. NATIONAL AND INTERNATIONAL POLITICAL AND
21 ECONOMIC EVENTS THAT AFFECT THE GENERAL STATE OF THE
22 ECONOMY CAN ALSO IMPACT A COMPANY'S REVENUE AND
23 EXPENSES. INDUSTRY-WIDE FACTORS IMPACT THE PROFIT
24 STABILITY OF ITS PARTICIPANTS. HOWEVER, PROBABLY
25 THE MOST DIRECT AND SIGNIFICANT FACTORS THAT AFFECT

1 A COMPANY'S BUSINESS RISK AND ITS REVENUE STREAM ARE
2 (1) THE COMPETITION FACING THE COMPANY'S PRODUCTS
3 AND SERVICES AND (2) THE ELASTICITY OF DEMAND FOR
4 THOSE PRODUCTS AND SERVICES. ADDITIONALLY, NEW
5 TECHNOLOGIES AND INNOVATIONS CAN AFFECT NOT ONLY THE
6 REVENUE STREAM BUT ALSO THE INVESTMENT AND EXPENSES
7 ASSOCIATED WITH THE OPERATIONS OF A BUSINESS.

8
9 IN SUMMARY, THE MAJOR FACTOR AFFECTING THE
10 DETERMINATION OF THE APPROPRIATE CAPITAL STRUCTURE
11 IS THE NATURE, MAGNITUDE AND DIRECTION OF THE
12 BUSINESS RISK FACING A COMPANY.

13

14 Q. WHAT EVIDENCE HAS SOUTHERN BELL PRESENTED REGARDING
15 CHANGES IN THE LEVEL OF BUSINESS RISK FACING THE
16 COMPANY?

17

18 A. AN OVERVIEW OF THE SOURCES OF THE COMPANY'S BUSINESS
19 RISK AND THE INCREASING NATURE OF THAT RISK IS
20 PROVIDED TO THE COMMISSION IN THIS DOCKET IN THE
21 TESTIMONY OF COMPANY WITNESS DENTON. MR. DENTON
22 DISCUSSES HOW THE TELECOMMUNICATIONS INDUSTRY HAS
23 CHANGED SINCE 1988 IN THE AREAS OF TECHNOLOGY,
24 STRATEGIC ALLIANCES, AND POLICY DECISIONS AT THE FCC
25 AND BY THIS COMMISSION. HIS TESTIMONY DETAILS

1 SIGNIFICANT ACTIVITIES THAT HAVE OCCURRED IN EACH OF
2 THOSE AREAS AND HOW THEY ACCELERATE THE PACE OF
3 COMPETITION IN THE MARKETPLACE. THE IMPACT OF THESE
4 ACTIVITIES ON THE FUTURE DIRECTION AND MAGNITUDE OF
5 THE BUSINESS RISK FACING THE COMPANY IS READILY
6 APPARENT. THE COMPANY'S BUSINESS RISKS IN FLORIDA
7 ARE SIGNIFICANT AND REAL. IN SUMMARY, MR. DENTON'S
8 TESTIMONY PROVIDES EVIDENCE THAT THE COMPANY'S
9 BUSINESS RISKS HAVE INCREASED MATERIALLY IN RECENT
10 YEARS AND CAN REASONABLY BE EXPECTED TO CONTINUE TO
11 INCREASE IN THE FUTURE.

12

13 Q. WHAT EVIDENCE IS AVAILABLE TO INVESTORS REGARDING
14 THE CURRENT AND FUTURE LEVEL OF BUSINESS RISK FACING
15 SOUTHERN BELL?

16

17 A. CREDIT RATING AGENCIES AND SECURITY ANALYSTS, WHO
18 FOLLOW THE TELECOMMUNICATIONS INDUSTRY, HAVE BEEN
19 REPORTING FOR SOME TIME TO INVESTORS THAT THE
20 INDUSTRY IS IN A TRANSITION STAGE TOWARD MORE
21 COMPETITION AND THAT BUSINESS RISKS HAVE BEEN
22 INCREASING AND WILL, WITHOUT A DOUBT, CONTINUE TO
23 INCREASE.

24

25 FOR EXAMPLE, BACK IN 1985, STANDARD AND POOR'S (S&P)

1 STARTED DOCUMENTING THE INCREASED COMPETITION AND
2 BEGAN MAKING ITS FINANCIAL BENCHMARKS MORE STRINGENT
3 FOR THE LOCAL EXCHANGE COMPANIES. IT HAS SINCE MADE
4 ADDITIONAL REFINEMENTS TO ITS BENCHMARKS, ALL OF
5 WHICH ARE EVEN MORE STRINGENT, BASED ON THE
6 INCREASING LEVEL OF BUSINESS RISKS FACING THE
7 INDUSTRY PARTICIPANTS.

8
9 AS ILLUSTRATION, IN A SEPTEMBER 17, 1990 CREDITWEEK
10 ARTICLE THAT ANNOUNCED RISK CLASSIFICATION CHANGES
11 FOR THE LOCAL EXCHANGE COMPANIES, STANDARD AND
12 POOR'S SAID:

13
14 "BOTH TECHNOLOGICAL AND ECONOMIC COMPETITION
15 ARE NOW PRIME DRIVERS FOR TELECOMMUNICATIONS
16 BUSINESS RISK, AND THEIR EFFECT STEMS IN LARGE
17 MEASURE FROM THE NATURE OF THE BUSINESS.
18 TECHNOLOGICAL CHANGE HAS PROVIDED VIABLE
19 ALTERNATIVES THAT ARE FULLY COMPETITIVE IN
20 CERTAIN APPLICATIONS. THE GROWING DEPLOYMENT
21 OF COMPETITIVE COMMUNICATIONS SERVICES IN ALL
22 SECTORS OF THE TELECOMMUNICATIONS INDUSTRY WILL
23 CONTINUE TO PUSH BUSINESS RISK TO GREATER
24 HEIGHTS FOR THE MAJORITY OF INDUSTRY
25 PARTICIPANTS. ... GOING FORWARD, THE INDUSTRY'S

1 INEXORABLY GROWING EXPOSURE TO COMPETITION WILL
2 OCCUR WITH OR WITHOUT THE RECOGNITION OR
3 ADMISSION BY MANAGER AND REGULATOR."
4

5 Q. GIVEN THE INCREASED LEVEL OF BUSINESS RISK, SUCH AS
6 THAT WHICH IS NOW FACING THE TELECOMMUNICATIONS
7 INDUSTRY AND SOUTHERN BELL, HOW SHOULD A COMPANY
8 RESPOND TO THIS INCREASED BUSINESS RISK ENVIRONMENT?
9

10 A. WHEN THE REVENUE STREAMS BECOME VULNERABLE TO
11 COMPETITION AND, THEREFORE, MORE VOLATILE AND LESS
12 PREDICTABLE, THE COMPANY'S MANAGEMENT SHOULD RESPOND
13 BY OFFSETTING THIS INCREASED BUSINESS RISK BY
14 REDUCING ITS FINANCIAL RISKS. THIS WILL ALLOW IT TO
15 ACHIEVE THE LOWEST OVERALL COST OF CAPITAL. THIS IS
16 PRIMARILY ACCOMPLISHED BY LOWERING THE AMOUNT OF
17 DEBT IN THE CAPITAL STRUCTURE.
18

19 Q. ARE THERE ANY OTHER FACTORS, IN ADDITION TO
20 BALANCING BUSINESS RISK CONSIDERATIONS, THAT
21 INFLUENCE A COMPANY'S DECISION AS TO THE AMOUNT OF
22 DEBT IT MAINTAINS?
23

24 A. YES. THERE IS A CLEARLY UNDERSTOOD DIRECT
25 RELATIONSHIP BETWEEN THE RISK AND THE REQUIRED

1 INVESTOR RETURN ASSOCIATED WITH A FINANCIAL
2 INVESTMENT. THE GREATER THE RISKS TO THE INVESTOR
3 OF A PARTICULAR INVESTMENT, THE GREATER WILL BE THE
4 INVESTOR'S REQUIRED RETURN ON THAT INVESTMENT. DUE
5 TO THE CONTRACTUAL NATURE OF DEBT AND THE PRIORITY
6 OF CLAIMS A DEBT INVESTOR HAS ON THE COMPANY'S
7 ASSETS, DEBT CAPITAL REPRESENTS AN ADDITIONAL RISK
8 TO THE EQUITY HOLDER. THIS RESULTS IN THE GENERALLY
9 ACCEPTED IDEA THAT, FOR A GIVEN FIRM, ITS DEBT COSTS
10 LESS THAN ITS EQUITY.

11
12 THIS CAPITAL COST RELATIONSHIP INFLUENCES COMPANIES
13 WHEN THEY DETERMINE THEIR CAPITAL STRUCTURE. THEORY
14 AND COMMON SENSE SUGGEST THAT A COMPANY SHOULD
15 ENDEAVOR TO MINIMIZE ITS COST OF SECURING CAPITAL
16 JUST AS IT TRIES TO MINIMIZE ALL OF ITS OTHER COSTS
17 OF DOING BUSINESS. GIVEN THAT THE COST OF DEBT IS
18 LESS THAN THE COST OF EQUITY, THE USE OF DEBT
19 FINANCING IS APPROPRIATE AND BENEFICIAL, UP TO A
20 POINT, BECAUSE IT CAN LOWER THE COMPANY'S OVERALL
21 COST OF DOING BUSINESS. THE USE OF TOO MUCH DEBT,
22 HOWEVER, CAN DRASTICALLY RAISE A COMPANY'S OVERALL
23 COST OF CAPITAL. THIS IS DUE TO THE FACT THAT TOO
24 MUCH DEBT CAUSES A COMPANY'S COST OF BOTH DEBT AND
25 EQUITY TO RISE. IN THIS SITUATION, THE COMPANY'S

1 OVERALL FINANCIAL RISK WILL, IN EFFECT, INCREASE.
2 EVIDENCE OF THIS POINT IS ABUNDANT SINCE, OVER THE
3 PAST SEVERAL YEARS, MANY COMPANIES TOOK ON TOO MUCH
4 DEBT. THEIR REVENUE STREAMS WERE TOO VOLATILE OR
5 JUST NOT STRONG ENOUGH TO SUPPORT THE BURDENS OF
6 THAT DEBT AND THEY HAVE SUFFERED FINANCIALLY.

7
8 ANOTHER FACTOR THAT INFLUENCES THE CAPITAL STRUCTURE
9 DETERMINATION IS THE NEED FOR A LEVEL OF
10 CREDITWORTHINESS AND SUFFICIENT BORROWING MARGIN TO
11 ENABLE THE COMPANY TO OPERATE AS AN ONGOING ENTITY,
12 GIVEN ITS BUSINESS RISKS. SOUTHERN BELL MUST
13 COMPETE FOR FUNDS IN THE CAPITAL MARKETS WITH THE
14 MAJOR U.S. AND FOREIGN INDUSTRIAL AND UTILITY FIRMS.
15 HIGH QUALITY CREDIT RATINGS ENABLE THE COMPANY TO
16 ATTRACT CAPITAL. DUE TO THE CONTINUING GROWTH IN
17 SOUTHERN BELL'S SERVICE TERRITORY, THE COMPANY'S
18 LARGE CAPITAL REQUIREMENTS, AND ITS UTILITY
19 OBLIGATION TO SERVE RATEPAYERS, SOUTHERN BELL MUST
20 BE ABLE TO COMPETE FOR REASONABLY-PRICED FUNDS,
21 REGARDLESS OF CAPITAL MARKET CONDITIONS. HIGH
22 QUALITY CREDIT RATINGS FACILITATE THIS PROCESS.

23

24 Q. PLEASE BRIEFLY DESCRIBE THE COMPANY'S CAPITAL
25 STRUCTURE.

1

2 A. THE COMPANY'S DEBT RATIO HAS REMAINED FAIRLY STABLE
3 DURING THE PAST SEVERAL YEARS. AS REFLECTED IN THE
4 SURVEILLANCE REPORTS TO THIS COMMISSION, SOUTHERN
5 BELL'S AVERAGE DEBT RATIO HAS VARIED WITHIN A NARROW
6 RANGE:

7		DEBT
8	<u>YEAR</u>	<u>RATIO</u>
9	1988	37.27%
10	1989	37.54
11	1990	37.09
12	1991	37.27
13	1992 (BST)	37.38

14

15 AS SHOWN ON MY EXHIBIT WBK-1, FOR YEAR 1993, THE
16 AVERAGE DEBT RATIO IS ESTIMATED TO BE 38.99%.

17

18 IN MY OPINION, GIVEN THE INCREASING BUSINESS RISK
19 FACING THE COMPANY AND THE RECENT RISE IN THE DEBT
20 RATIO, THE COMPANY'S OVERALL RISK, WHICH IS THE
21 COMBINATION OF THE BUSINESS AND FINANCIAL RISKS, HAS
22 INCREASED IN RECENT YEARS.

23

24 Q. WHAT HAS BEEN THE HISTORY OF THIS COMMISSION'S
25 REGULATORY PRACTICE REGARDING THE CAPITAL STRUCTURE

1 ISSUE AS APPLIED TO SOUTHERN BELL?

2

3 A. THIS COMMISSION, SINCE DIVESTITURE, HAS REGULATED
4 SOUTHERN BELL BASED ON THE COMPANY'S ACTUAL AVERAGE
5 CAPITAL STRUCTURE. THE CONTINUED USE OF THE
6 COMPANY'S ACTUAL CAPITAL STRUCTURE IN THIS
7 PROCEEDING IS APPROPRIATE. BY DOING SO, THE
8 COMMISSION IS RECOGNIZING THAT A COMPANY'S ACTUAL
9 CAPITAL STRUCTURE BEST REFLECTS THE REALITIES OF THE
10 COMPANY'S FINANCIAL SITUATION AND IT IS THAT CAPITAL
11 STRUCTURE WHICH IS READILY AVAILABLE TO THE
12 INVESTORS WHEN THEY ARE EVALUATING INVESTMENT
13 OPPORTUNITIES.

14

15 Q. WHAT IS YOUR RECOMMENDATION TO THIS COMMISSION
16 REGARDING THE APPROPRIATE CAPITAL STRUCTURE AND COST
17 RATES THAT SHOULD BE USED IN CONNECTION WITH THIS
18 PROCEEDING?

19

20 A. CONSISTENT WITH PAST PRACTICES OF THIS COMMISSION
21 AND THE CURRENT FINANCIAL REALITIES OF THE COMPANY,
22 I RECOMMEND THAT THE COMMISSION CONTINUE TO USE THE
23 COMPANY'S ACTUAL AVERAGE CAPITAL STRUCTURE AND THE
24 ACTUAL COST RATES.

25

1 BESIDES PAST COMMISSION PRACTICE, THERE ARE SEVERAL
2 OTHER REASONS WHY THE COMPANY'S ACTUAL CAPITAL
3 STRUCTURE IS APPROPRIATE. AGAIN, INVESTORS ASSESS
4 THE COMPANY'S FINANCIAL RISK BASED ON ITS ACTUAL
5 CAPITAL STRUCTURE, AS IT IS REFLECTED IN ITS
6 PUBLISHED FINANCIAL STATEMENTS. SECOND, IN A
7 REGULATORY CONTEXT, THE USE OF A HYPOTHETICAL,
8 RATHER THAN AN ACTUAL CAPITAL STRUCTURE, CREATES A
9 SITUATION WHERE THE FINANCIAL RESULTS OF RATEMAKING
10 WILL NOT, IN FACT, BE ACHIEVED BY THE INVESTORS.

11

12 AS ILLUSTRATION OF THIS LAST POINT, LET ME PROVIDE
13 AN EXAMPLE. SUPPOSE THAT THE UTILITY HAS A CAPITAL
14 STRUCTURE OF 40% DEBT AND 60% EQUITY. IF ITS DEBT
15 COST RATE WAS 8% AND ITS COST OF EQUITY WAS 14%, ITS
16 OVERALL COST OF CAPITAL WOULD BE 11.6%. IF THE
17 COMPANY'S RATE BASE WAS \$1,000 AND IT HAD A TAX RATE
18 OF 40%, THIS WOULD MEAN THAT THE REVENUE
19 REQUIREMENTS NEEDED TO SATISFY THE INVESTORS'
20 REQUIREMENTS WOULD BE \$172.00.

21

22 RATE BASE x [{(ROE x EQUITY RATIO)/(1 - TAX RATE)} +
23 (DEBT COST x DEBT RATIO)]

24

25 1000 x [{(.14 x .60)/(1 - .40)} + (.08 x .40)]

1
2 NOW SUPPOSE THAT THE COMMISSION WAS TO AUTHORIZE THE
3 COMPANY'S COST RATES BUT DECIDED TO ADOPT A
4 HYPOTHETICAL CAPITAL STRUCTURE OF 50% DEBT AND 50%
5 EQUITY. THIS REGULATORY DECISION WOULD RESULT IN
6 RATES DESIGNED TO PRODUCE ONLY \$156.67 IN ADDITIONAL
7 REVENUES. FROM THIS EXAMPLE, YOU CAN SEE THAT A
8 \$15.33 SHORTFALL WAS CREATED FROM THE INVESTORS'
9 REQUIRED RETURN TO THE ADDITIONAL REVENUES
10 AUTHORIZED BECAUSE A HYPOTHETICAL CAPITAL STRUCTURE
11 WAS USED. THIS SHORTFALL IS WHAT I WAS REFERRING TO
12 WHEN I INDICATED THAT THE USE OF A HYPOTHETICAL,
13 RATHER THAN AN ACTUAL CAPITAL STRUCTURE, CREATES A
14 SITUATION WHERE THE FINANCIAL RESULTS OF RATEMAKING
15 WILL NOT BE ACHIEVED BY THE INVESTORS.

16

17 Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT THE POSSIBLE
18 USE OF CAPITAL STRUCTURE DIFFERENT FROM THE
19 COMPANY'S ACTUAL CAPITAL STRUCTURE?

20

21 A. YES. THE SIGNAL THAT WOULD BE SENT TO INVESTORS BY
22 THE USE OF A HYPOTHETICAL CAPITAL STRUCTURE WOULD BE
23 NEGATIVE, COULD ULTIMATELY CAUSE FINANCIAL HARM TO
24 THE COMPANY, AND COULD INCREASE THE COST OF
25 TELECOMMUNICATIONS SERVICES. THIS CONCERN WAS

1 EXPLICITLY RECOGNIZED BY THIS COMMISSION, IN ORDER
2 20162 IN SOUTHERN BELL DOCKET NO. 880069-TL, DATED
3 OCTOBER 13, 1988, WHEN IT STATED THAT

4

5 "IMPUTING A LOWER EQUITY RATIO REDUCES THE
6 COMPANY'S ABILITY TO EARN ON ITS ACTUAL CAPITAL
7 STRUCTURE. IMPUTING A LOWER EQUITY RATIO COULD
8 ALSO ADVERSELY AFFECT THE COMPANY'S ABILITY TO
9 REACT TO CHANGES IN ITS OPERATING ENVIRONMENT
10 AND COULD POSSIBLY RESULT IN A LOWER BOND
11 RATING FOR THE COMPANY."

12

13 Q. WHAT IS THE COMPOSITION OF THE CAPITAL STRUCTURE
14 THAT THE COMPANY IS RECOMMENDING?

15

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

19

20 AT THE TOP OF THAT EXHIBIT IS SHOWN THE UPDATED
21 ESTIMATE OF THE COMPANY'S AVERAGE CAPITAL STRUCTURE
22 FOR 1993. THE LOWER PORTION OF THAT EXHIBIT
23 REFLECTS THE FLORIDA INTRASTATE AVERAGE CAPITAL
24 STRUCTURE FOR 1993 THAT IS RECONCILED WITH THE
25 FLORIDA INTRASTATE RATE BASE PRESENTED IN THE

1 UPDATED TESTIMONY OF COMPANY WITNESS REID.

2

3 Q. PLEASE EXPLAIN HOW THE COMPANY'S AVERAGE 1993
4 CAPITAL STRUCTURE, SHOWN ON THE TOP OF THAT EXHIBIT,
5 WAS ESTIMATED.

6

7 A. FOR THE MONTHS UP TO AND INCLUDING JULY, 1993,
8 ACTUAL COMPANY DATA WAS USED. THE MONTHLY DATA FOR
9 AUGUST THROUGH DECEMBER HAD TO BE ESTIMATED. THE
10 FOLLOWING APPROACH WAS USED FOR THOSE MONTHS:

11

12 FOR LONG-TERM DEBT

13

14 THE LEVEL OF FUNDED DEBT WAS ESTIMATED MONTHLY
15 RECOGNIZING THE REFINANCING THAT WAS INITIATED
16 IN AUGUST. NO OTHER REFINANCINGS WERE ASSUMED
17 TO OCCUR IN 1993. THE AVERAGE LEVEL OF OTHER
18 LONG-TERM DEBT AND CAPITALIZED LEASES FOR THE
19 PERIOD JANUARY THROUGH JULY WAS USED AS THE
20 LEVEL FOR EACH MONTH, AUGUST THROUGH DECEMBER.

21

22 FOR SHORT-TERM DEBT

23

24 THE AVERAGE LEVEL OF COMMERCIAL PAPER FOR THE
25 PERIOD JANUARY THROUGH JULY WAS USED AS THE

1 LEVEL OF COMMERCIAL PAPER FOR EACH MONTH,
2 AUGUST THROUGH DECEMBER. THE AVERAGE LEVEL OF
3 SHORT-TERM CAPITALIZED LEASES FOR THE PERIOD
4 JANUARY THROUGH JULY WAS USED AS THE LEVEL FOR
5 EACH MONTH, AUGUST THROUGH DECEMBER.

6

7 FOR COMMON EQUITY

8

9 THE AVERAGE LEVEL OF COMMON EQUITY FOR THE
10 PERIOD JANUARY THROUGH JULY WAS USED AS THE
11 LEVEL OF COMMON EQUITY FOR EACH MONTH, AUGUST
12 THROUGH DECEMBER.

13

14 USING THE APPROACH JUST DESCRIBED RESULTS IN AN
15 ESTIMATED CAPITAL STRUCTURE WHICH IS SLIGHTLY
16 DIFFERENT FROM THE COMPANY'S 1993 COMMITMENT VIEW.
17 THE CAPITAL STRUCTURE SHOWN ON THE TOP OF MY EXHIBIT
18 WBK-1 HAS A SLIGHTLY HIGHER DEBT RATIO PRIMARILY
19 BECAUSE THE COMMITMENT VIEW DOES NOT REFLECT THE
20 REFINANCING THAT HAVE OCCURRED IN 1993.

21

22 Q. WHAT ARE THE COST RATES THAT THE COMPANY IS
23 RECOMMENDING?

24

25 A. THE AVERAGE COST RATE FOR THE COMPANY'S LONG-TERM

1 DEBT FOR THE YEAR 1993 IS EXPECTED TO BE 8.02%. THE
2 CALCULATION OF THIS COST RATE IS SHOWN AT THE TOP OF
3 EXHIBIT WBK-2. IN ARRIVING AT THAT FIGURE, AN
4 AVERAGE COST RATE FOR FUNDED DEBT WAS ESTIMATED (1)
5 RECOGNIZING THE FEBRUARY REFINANCING, THE TWO
6 REFINANCINGS THAT WERE INITIATED IN MAY, THE
7 REFINANCING THAT WAS INITIATED IN JUNE, AND THE
8 REFINANCING THAT WAS INITIATED IN AUGUST, AND (2)
9 ASSUMING NO ADDITIONAL REFINANCINGS DURING 1993.
10 THIS IS THE FIGURE THAT THE COMMISSION WOULD
11 NORMALLY USE.

12
13 HOWEVER, FOR THIS PARTICULAR PROCEEDING, THE COMPANY
14 RECOMMENDS THAT THE COMMISSION USE A DIFFERENT COST
15 RATE FOR LONG-TERM DEBT. SINCE THE BEGINNING OF
16 1993, THE COMPANY HAS REFINANCED \$2.06 BILLION
17 (NEARLY 33%) OF ITS DEBT. THESE REFINANCINGS HAVE
18 REDUCED THE COMPANY'S COST OF FUNDED DEBT FROM 8.48%
19 TO AN ESTIMATED 7.65% AS OF THE END OF SEPTEMBER.
20 IN RECOGNITION OF THESE EVENTS, I HAVE PROVIDED THE
21 THE CALCULATION OF THE COMPANY'S ESTIMATED COST FOR
22 LONG-TERM DEBT AS OF SEPTEMBER 30, 1993 AT THE
23 BOTTOM OF EXHIBIT WBK-2. THAT COST RATE IS 7.68%.
24 THIS IS THE COST RATE THAT I WILL USE FOR
25 DETERMINING THE OVERALL COST OF CAPITAL BECAUSE IT

1 REFLECTS THE COMPANY'S GOING-FORWARD ACTUAL INTEREST
2 OBLIGATIONS.

3
4 THE AVERAGE COST RATE FOR THE COMPANY'S SHORT-TERM
5 DEBT FOR THE YEAR 1993 IS EXPECTED TO BE 3.30%. THE
6 CALCULATION OF THIS COST RATE IS SHOWN ON EXHIBIT
7 WBK-3. ACTUAL COST RATES WERE USED FOR MONTHS UP TO
8 AND INCLUDING JULY. THE AVERAGE COST RATE FOR THE
9 PERIOD FROM JANUARY THROUGH JULY WAS USED AS THE
10 COST RATE FOR THE MONTHS, AUGUST THROUGH DECEMBER.

11
12 THE COST RATES FOR BOTH THE CUSTOMER DEPOSITS AND
13 INVESTMENT TAX CREDITS WERE COMPUTED ACCORDING TO
14 COMMISSION RULES AND PROCEDURES. THE UNDERLYING
15 DATA FOR CUSTOMER DEPOSITS WAS PROVIDED IN THE
16 OCTOBER 1, 1993 UPDATE TO THE MINIMUM FILING
17 REQUIREMENTS (MFR), SCHEDULE D-5.

18
19 THE TESTIMONY AND EXHIBITS OF DR. BILLINGSLEY
20 PROVIDE EVIDENCE THAT THE COMPANY'S CURRENT COST OF
21 EQUITY IS IN THE RANGE OF 13.90% TO 14.18%. THE
22 MIDPOINT OF THIS RANGE IS APPROXIMATELY 14.0%, WHICH
23 IS STILL WITHIN THE PARAMETERS OF THE EXISTING
24 INCENTIVE SHARING PLAN.

25

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

2

3 A. ON EXHIBIT WBK-4, I HAVE COMPUTED THE COMPANY'S
4 OVERALL COST OF CAPITAL TO BE 9.35% BY COMBINING THE
5 INDICATED 14.0% MIDPOINT OF THE RANGE OF COST OF
6 EQUITY WITH THE APPROPRIATE CAPITAL STRUCTURE
7 COMPONENTS AND THE VARIOUS OTHER COST COMPONENTS.

8

9

10 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

11

12 A. YES, IT DOES.

13

14

15

16

17

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25

FPSC EXHIBIT NUMBER _____
 FPSC DOCKET 920260-TL
 KECK EXHIBIT WBK-1 (UPDATED 10/1/93)
 AVERAGE CAPITAL STRUCTURE
 PAGE 1 OF 1

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	\$ 6,192,045	33.20%
Short-Term Debt	1,080,367	5.79
Common Equity	<u>11,377,609</u>	<u>61.01</u>
 TOTAL CAPITAL	 \$18,650,021	 100.00%

ADJUSTED 1993 FLORIDA INTRASTATE CAPITAL STRUCTURE

	Amount (\$000)	Percent of Total
Long-Term Debt	\$ 1,063,579	26.29%
Short-Term Debt	185,485	4.59
Common Equity	1,954,486	48.31
Preferred Stock	0	0.00
Customer Deposits	55,679	1.38
Cost Free Capital	681,040	16.83
Investment Tax Credits	<u>105,161</u>	<u>2.60</u>
 TOTAL CAPITAL	 \$ 4,045,430	 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	\$ 6,163,313	\$ 493,287,000	8.00%
Other Long-Term Debt	1,307	117,069	8.96
Capital Leases	27,425	3,464,138	12.63
TOTAL LONG-TERM DEBT	\$ 6,192,045	\$ 496,868,207	8.02%

COST FOR LONG-TERM DEBT
Estimated as of SEPTEMBER 30, 1993

<u>Long-Term Debt</u>	<u>Amount (\$000)</u>	<u>Annual Interest</u>	<u>Cost Rate</u>
Funded Debt	\$ 6,225,484	\$ 476,462,000	7.65%
Other Long-Term Debt	1,302	116,641	8.96
Capital Leases	27,349	3,496,726	12.79
TOTAL LONG-TERM DEBT	\$ 6,254,135	\$ 480,075,367	7.68%

FPSC EXHIBIT NUMBER _____
FPSC DOCKET 920260-TL
KECK EXHIBIT WBK-3 (UPDATED 10/1/93)
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	\$ 1,070,805	\$ 34,445,441	3.22%
Capital Leases	9,562	1,209,958	12.65
TOTAL SHORT-TERM DEBT	\$ 1,080,367	\$ 35,655,399	3.30%

FPSC EXHIBIT NUMBER _____
FPSC DOCKET 920260-TL
KECK EXHIBIT WBK-4 (UPDATED 10/1/93)
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	\$ 1,063,579	26.29%	7.68%	2.02%
Short-Term Debt	185,485	4.59	3.30	.15
Common Equity	1,954,486	48.31	14.00	6.76
Preferred Stock	0	0.00	0.00	0.00
Customer Deposits	55,679	1.38	8.23	.11
Cost Free Capital	681,040	16.83	0.00	0.00
Investment Tax Credits	105,161	2.60	11.77	.31
TOTAL CAPITAL	\$ 4,045,430	100.00%		9.35%