

1 exchange monopoly in the state and its status as a wholly owned subsidiary of Bell Atlantic. I
2 will examine these risk claims one by one.

3 First, the subject of universal service support is being addressed in the federal
4 jurisdiction and will undoubtedly also be addressed by this Commission if the federal solution is
5 not sufficient to meet the state's needs. There is every reasonable expectation that explicit and
6 targeted support to carriers serving low-income customers and high-cost areas will be in place
7 by the end of 1997. If it is not, of course, BA-Del should then be allowed to demonstrate to
8 the Commission that it is losing money and needs relief. At present, however, investors do not
9 appear to be deterred by BA-Del's COLR obligations.

10 Second, BA-Del's exclusion from the interLATA toll market will, under the Act, end as
11 soon as the Company satisfies the §271 Competitive Checklist. BA-Del has indicated to Staff
12 that it will be ready to file with the FCC within the next three months for approval to enter the
13 interLATA toll market. Many of the terms of the Statement filed in this proceeding are
14 apparently intended to satisfy the Checklist.

15 Third, while changing technology always raises the possibility of stranded investment,
16 the current position of BA-Del as the dominant provider of local loops is unlikely to be seriously
17 eroded for some years. And there has been no showing that the Company's installed base of
18 copper cable will become economically obsolete prior to the end of its currently authorized
19 depreciation schedule. While fiber optic cable and the associated electronics continue to decline
20 in cost, and while fiber holds the potential for handling video dial tone, broadband data services,
21 and other offerings that require an enormous expansion of bandwidth, that does not mean the
22 existing copper cable is an albatross hanging around the Company's neck. To the contrary,
23 manufacturers are working aggressively on new technologies that hold the potential for offering
24 higher bandwidth services over ordinary copper wires. Nor is the specter of future low cost
25 wireless competition particularly frightening in a state as compact and densely populated as
26 Delaware.

1 Fourth, in response to Dr. Vander Weide's claim (at 17) that "regulation impairs BA-
2 Del's ability to compete on the same terms as its competitors," I would observe that while this
3 may be residually true (and the residue shrinks almost daily), any remaining regulatory handicap
4 is more than offset by BA-Del's enormously valuable market presence, including its standing as
5 THE telephone company, its long-established network, its established customer base and its
6 unmatched knowledge of the market. Competitors have a steep uphill fight to enter the state
7 and win market share.

8 Finally, while it is true that investment in LECs involves high operating leverage, this will
9 be equally true of any facilities-based competitor, and that competitor faces the even more
10 daunting problem of predicting what share of the market it will gain, and thus what size network
11 to install.

12
13 **Q. Does the stock market appear to share Dr. Vander Weide gloomy view of BA's**
14 **prospects?**

15 A. No. For instance, at the close of trading on January 21, 1997, Bell Atlantic's stock price stood
16 at 67. While this below its all-time high, it is comfortably above its 52-week low of \$55.12. If
17 investors thought the obligations and opportunities created by the trend towards increased
18 competition were, on balance, as unattractive as Dr. Vander Weide seems to think, why would
19 the stock price remain at such a substantial level above book value? Here's what *Finance*
20 *Over Fifty*, a newsletter for persons nearing retirement, recently had to say about the relative
21 riskiness of Bell Atlantic:

22
23 Bell Atlantic, an original regional bell operating company (RBOC), provides
24 telecommunications services in six Atlantic states and Washington, D.C. It also
25 has stakes in companies that operate in New Zealand and the Czech Republic. It
26 is one of only three RBOCs to have raised its dividend every year. The firm will
27 soon be merging with NYNEX, another RBOC. The merger should provide
28 significant cost synergies in NYNEX's densely populated northeastern U.S.
29 coverage area. This is a high-yield, *low-risk* way to participate in the growing
30 communications and technology fields.

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2 As reported in *The Tallahassee Democrat* of January 22, 1997, p. 9D, emphasis added.

3 If the risks facing Bell Atlantic were truly very high, it seems unlikely that investors
4 would continue to bid the price up, and help maintain a stock price that is consistently well
5 above net book value.

6
7 **Q. Given BA's past stock performance and level of risk, do you agree with Dr. Vander**
8 **Weide's assignment to the Company of a ***BA PROPRIETARY BEGINS*****
9 *****BA PROPRIETARY ENDS***cost of equity?**

10 A. No, I do not. Dr. Vander Weide arrived at this figure by applying the Discounted Cash Flow
11 (DCF) model to the Standard & Poor's Industrials, market-weighted, claiming that this is
12 "reflective of companies operating in a competitive environment." BA-Del Exhibit No. 4, at 19-
13 20. Even granting that the trend is towards increased competition, it is implausible to suggest
14 that the entrenched giants of the industry are already as risky as the average industrial firm.
15 While some of industrial firms (e.g., Coca Cola, General Mills, Boeing), enjoy enormous
16 market presence and extremely high market shares, they certainly don't surpass Bell Atlantic in
17 this regard. Yet, other firms within the overall industrial group are in a much weaker, more
18 tenuous competitive position. Thus, it is hardly credible to suggest that Bell Atlantic no longer
19 enjoys any risk advantage relative to the overall average of the Standard & Poor's Industrials.

20 For this and other reasons, his *****BA PROPRIETARY BEGINS*****
21 *****BA PROPRIETARY ENDS***** equity cost estimate is clearly too high. While I have not
22 performed a specific equity cost analysis for purposes of this proceeding, I have used a figure of
23 12% in preparing my cost studies. This is the same cost of equity figure I have used in other
24 jurisdictions in the past year, and it is the same cost of equity found by the Commission for
25 BA-Del in PSC Docket 92-47. It could be argued that increased competition for BA-Del's
26 customers as a result of the passage of the 1996 Telecom Act will increase the Company's
27 level of risk and thus its cost of equity. However, the Act has also removed many of the

1 restrictions hampering BA-Del's ability to compete for other firms' customers. For example,
2 the Company is now allowed to enter the video market and could soon be entering the
3 interLATA toll market. Accordingly, I believe that this 12% figure continues to be a reasonable
4 one to use. It is substantially less than the figure used by the Company in the studies it submitted
5 in this proceeding
6

7 **Q. Dr. Vander Weide also assigns BA an equity ratio of ***BA PROPRIETARY**
8 **BEGINS*** ***BA PROPRIETARY ENDS***. Is this reasonable?**

9 A. No, it is not. According to Dr. Vander Weide,

10
11 The average market-based percentages of debt and equity in the capital
12 structures of the S&P Industrials [the figure he used for BA-Del] is a good proxy
13 for the capital structures of competitive firms on a forward-looking economic
14 basis.
15

16 Id., at 20. He also points out that this capital structure is very close to that of the Regional Bell
17 Holding Companies. Id. What this position ignores is that current market prices reflect a
18 relatively strong bull market that has pushed equity prices to historically high levels. The bidding
19 up of equity prices causes a market-based ratio of equity to debt to increase accordingly. When
20 analyzing the cost of capital, regulators have traditionally anchored the debt/equity ratios to a
21 level which is cost effective, and not allowed the ratio to swing about, based upon market
22 fluctuations or corporate strategies. I think this is a sound practice, which should apply in the
23 context of this proceeding. If we are to calculate the long run cost of BA-Del's network, it
24 should be based upon a reasonable economical and efficient capital structure. Since the
25 Company can raise debt capital at a cost which substantially below its cost of equity, and its
26 ability to deduct the resulting interest expense from its state and federal income taxes, it isn't
27 appropriate to set regulated rates based upon a high equity ratio, which translates into
28 unnecessarily high costs.
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