Q. WHAT IS YOUR DCF ESTIMATE OF THE COST OF EQUITY CAPITAL?

A. Attachment JH-4 presents the DCF estimates of the cost of equity capital derived from the three-stage model for the telephone company sample. The estimates range from a low of 9.13 percent to a high of 11.07 percent.[1]

Using the DCF approach, the cost of equity capital for Verizon is estimated to be 10.24 percent, based on a value-weighted average of the equity cost of capital for all telephone holding companies (excluding Verizon) and the cost of capital for Verizon itself. The table below shows how this weighted average cost of equity capital was computed:

WEIGHTED AVERAGE DCF COST OF EQUITY FOR VERIZON

	Weight	Rate	Weighted Cost
Average (excluding Verizon)	.75	9.96%	7.47
Verizon	.25	11.07%	2.77
Weighted Cost of Equity			**10.24%**

[1] Because Century Telephone has a very small dividend yield of **0.77%**, applying the DCF model yields a cost of equity estimate that is not meaningful. As I note later in my testimony, the DCF approach may be less accurate for companies that pay small dividends. Consequently, I exclude Century Telephone from the DCF cost of equity calculation. However, I still include Century Telephone's CAPM cost of equity estimate. Because Century Telephone has a small market value of equity, its exclusion from the DCF calculation has a minimal (although slightly conservative) effect on the DCF cost of equity estimate for Verizon.

A. Yes. Salomon Brothers in its January 1996 report "Regional Bell Operating Companies— Opportunities Ring … While Danger Calls" stated that,

> "[b]ased on our estimates, the RBOCs currently have an average weighted cost of capital of approximately 8.6%. In order to value the RBOCs on a level playing field, we used the same discount rate in each DCF. Specifically, we used a discount rate of 10%, which we believe should be the minimum return an investor would expect in order to entice him to invest in a security, despite the fact this is slightly above the cost of capital."

As part of its proposed merger with NYNEX, **(then Bell Atlantic) submitted to its shareholders a joint proxy statement/prospectus on September 16, 1996 in which Bell Atlantic's** investment advisor, Merrill Lynch, performed a DCF analysis of the two companies' relative market values, estimating a discount rate in the range of **8% to 10%** for the telephone company portion of its portfolio of businesses.

Q. ARE THERE MORE RECENT PUBLICLY-AVAILABLE COST OF CAPITAL ESTIMATES WHICH CONFIRM THE REASONABLENESS OF YOUR COST OF CAPITAL RANGE?

A. Yes. Some appear in a prospectus related to the formation of Verizon itself.

In the Bell Atlantic-GTE merger prospectus filed with the SEC on April 14, 1999, Bell Atlantic's financial advisors, Merrill Lynch and Bear Stearns, used a range of discount rates from **8.5% to 10.5%** to determine the exchange ratios of Bell Atlantic and GTE shares. Notably, Bell Atlantic's advisors performed an illustrative valuation of the expected combination benefits where they discounted expected incremental free cash flows using a discount rate of **9.5%**, the midpoint of the discount rate range from 7.5% to 11.5%. In the same Bell Atlantic-GTE merger proxy statement, GTE's