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August 14, 1996

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Re: Docket No. 920260-TL

Dear Ms. Bayo:

Enclosed for filing and distribution are the original and fifteen copies of the Testimony of Joseph Gillan On Behalf of The Florida Interexchange Carriers Association in the above docket.

Please acknowledge receipt of the above on the extra copy enclosed herein and return it to me. Thank you for your assistance.

Sincerely,

Vicki Gordon Kaufman

Vicki Gordon Kaufman

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FPSC-RECORDS/REPORTING

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In re: Comprehensive Review of the)	Docket No. 920260-TL
Revenue Requirements and Rate)	Filed: August 14, 1996
Stabilization Plan of Southern Bell)	
Telephone and Telegraph Company)	
<hr/>)	

TESTIMONY OF JOSEPH GILLAN
ON BEHALF OF
THE FLORIDA INTEREXCHANGE CARRIERS ASSOCIATION

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In re: Comprehensive Review of the Revenue Requirements and Rate Stabilization Plan of Southern Bell Telephone and Telegraph Company)
Docket No. 920260-TL)
Filed: August 14, 1996)
_____)

TESTIMONY OF JOSEPH GILLAN
ON BEHALF OF
THE FLORIDA INTEREXCHANGE CARRIERS ASSOCIATION

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FPSC-RECORDS/REPORTING

1 **I. Introduction**

2

3 **Q. Please state your name and business address.**

4

5 A. My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando,
6 Florida 32854.

7

8 **Q. What is your occupation?**

9

10 A. I am an economist with a consulting practice specializing in telecommunications.
11 My clients span a range of interests and have included state public utility
12 commissions, consumer advocate organizations, local exchange carriers,
13 competitive access providers and long distance companies.

14

15 **Q. Please briefly outline your educational background and related experience.**

16

17 A. I am a graduate of the University of Wyoming where I received B.A. [1978] and
18 M.A. [1979] degrees in economics. My graduate program concentrated on the
19 economics of public utilities and regulated industries.

20

21 In 1980 I joined the Illinois Commerce Commission where I had responsibility for
22 policy analysis relating to the emergence of competition in regulated markets, in
23 particular the telecommunications industry. While on the staff of the Commission,

1 I served on the staff subcommittee for the NARUC Communications Committee
2 and was appointed to the Research Advisory Council overseeing NARUC's
3 research arm, the National Regulatory Research Institute.

4
5 In 1985 I left the Commission to join U.S. Switch, a venture firm organized to
6 develop interexchange access networks in partnership with independent local
7 telephone companies. At the end of 1986, I resigned my position as Vice
8 President-Marketing to begin a consulting practice. I currently serve on the
9 Advisory Council for New Mexico State University's Center for Regulation.

10
11 **Q. On whose behalf are you testifying?**

12
13 **A.** I am testifying on behalf of the Florida Interexchange Carriers Association
14 (FIXCA). Although FIXCA is best known (and presently labeled) by its ancestral
15 roots as an association of competitive *long distance* companies, this
16 characterization is far too limiting. FIXCA should more appropriately be
17 considered an association of competitive *telecommunication* providers that are
18 dependent, to one extent or another, on the use of the incumbent LEC's network
19 to provide service. Today, these carriers primarily provide long distance services,
20 but I would expect that most (if not all) of FIXCA's members will soon seek the
21 ability to offer all manner of telecommunication services. What will not change -
22 - even for those members who are involved in constructing local networks -- is a
23 substantial dependence upon BellSouth to meet some, or all, of their exchange

1 network needs.

2
3 **Q. What is the purpose of your testimony?**

4
5 A. The central purpose of my testimony is to support the access charge reduction that
6 lies at the heart of the Joint Proposal sponsored by a coalition of users and
7 competitive providers, including FIXCA. I recognize that the novelty has long
8 since worn thin on testimony supporting access charge reductions sponsored by
9 interexchange carriers. But stop, don't put this testimony down just yet. However
10 familiar this testimony *may seem*, the underlying message is *new*: Cost-based
11 access charges, long the preferred policy, are now a policy imperative due to the
12 federal Telecommunications Act of 1996 (Act). The unspecified rate reduction
13 required by the BellSouth Stipulation is the Commission's last best chance to
14 implement this reform.

15
16 In the testimony which follows, I make three fundamental points:

17
18 * The core benefits of the federal Act can only be realized if all of
19 BellSouth's carrier-charges, including access, are cost-based. One
20 of the Act's most significant (potential) benefits is the development
21 of *competitively* drawn local calling areas -- but providers cannot
22 compete along this important service dimension if the rates they
23 must pay for the use of BellSouth's network depend upon

1 *BellSouth's* labeling of a call as local or toll. Among other
2 conclusions, access and interconnection charges must be equal in
3 order for service-boundary competition to become a reality.

4
5 * The time to achieve access reform is now. The Stipulation
6 provides for a mandated, *specified* reduction in intrastate access to
7 December 1993 interstate levels (which the Florida
8 Telecommunications Act moved to December 1994 levels). In
9 addition, the Stipulation permits additional access reductions
10 through the disposition of discretionary, *unspecified* reductions.
11 Significantly, this final disposition of unspecified revenues required
12 under the BellSouth Stipulation is the Commission's last
13 opportunity to order an access reduction.

14
15 * The Stipulation's *specified* access reduction to interstate levels
16 should be accomplished with a reduction in the CCLC rate element
17 because it is this element that is most responsible for intrastate rates
18 exceeding interstate rates. The Commission should then use a
19 portion of the discretionary, *unspecified* reduction to eliminate the
20 "residual interconnection charge" or RIC. The Commission has
21 already concluded that the RIC is competitively disruptive, without
22 cost justification, and should be eliminated. Consequently, no
23 policy question is at issue, only the implementation of a prior

1 Commission decision. The Commission should flatly reject
2 BellSouth's proposal to strategically price access service by
3 selectively reducing rates without any underlying cost justification.
4

5 In short, my testimony shows that access charge reductions are even more
6 important under the new federal Act than before; the final step in implementing
7 the Stipulation is the Commission's last opportunity to move access rates toward
8 cost; and the specific rate eliminated by the Joint Proposal's recommended use of
9 the unspecified reduction is consistent with a prior Commission order.
10

11 **II. Realizing the Federal Act's Full Potential Demands Access Reductions**

12

13 **Q. Why are cost-based access charges a predicate to fully implementing the new**
14 **federal Act?**

15
16 **A.** When fully implemented, the federal Act is intended to fundamentally change the
17 way that telecommunication services are packaged and priced. Significantly, cost-
18 based access charges figure prominently in achieving "full service competition,"
19 where companies offer packages of services and the traditional lines between local
20 and toll become increasingly blurred. The Commission has already experienced
21 the beginnings of this trend with the introduction of ECS service by BellSouth.
22 Of course, as FIXCA has emphasized before, the problem with BellSouth's ECS
23 product is that *only* BellSouth is able to offer the service due to the excessive

1 access charges that BellSouth imposes on others (but more on that later).

2
3 **Q. How can consumers be provided with a variety of local calling boundaries**
4 **from which to choose?**

5
6 A. The key is correctly pricing access/interconnection service so that a carrier's cost
7 to terminate a call is not dependent upon BellSouth's retail classification. If both
8 access (for "toll") and interconnection (for "local") call termination charges are the
9 same, then carriers will be free to design products with differing boundaries, with
10 the goal to attract subscribers by offering a "better" local calling area.

11
12 Such an environment, however, absolutely requires non-discriminatory termination
13 rates that do not attempt to differentiate between types of calls. Otherwise, all
14 carriers would have their cost-structure defined by BellSouth's retail rate structure
15 -- a low cost to terminate a "local" call, a higher cost to complete a "toll" call --
16 and BellSouth's local calling boundaries would dominate the market.

17
18 A far better outcome is based on non-discriminatory, cost-based charges for call
19 termination, irrespective of any *label* on the call. With such non-discriminatory
20 charges, carriers would be free to decide the scope of their own local calling
21 areas, sizing these areas to match their own perception of the market and to reflect
22 their own pricing and marketing strategies. In this way, the market -- which is to
23 say, *consumers* -- would decide the size and shape of the local calling area as

1 carriers compete along this important dimension of service.

2
3 **Q. Do you believe that competition is one of the goals of the federal Act?**

4
5 A. Yes. I believe that the competitive endpoint of the Act is an discrimination-free
6 environment of cost-based carrier charges that permits competition on every
7 service dimension, including calling boundaries. I am not alone in this opinion;
8 this is also the endpoint described by the United States Telephone Association
9 (USTA), of which BellSouth is a member:

10
11 Ultimately, the 1996 Act contemplates a competitive endpoint
12 where the pricing of local interconnection is not dependent upon
13 the identity of the interconnecting entity, e.g. an IXC, a CAP, a
14 CLEC, a CMRS provider or an information service provider.

15 USTA Comments, FCC Docket CC 96-98 at 3.

16
17 **Q. Does BellSouth agree that interconnection prices should be non-**
18 **discriminatory?**

19
20 A. Yes. In BellSouth's Comments to the FCC on these same issues, BellSouth
21 recommended that:

22
23 The [Federal Communications] Commission should take a

1 comprehensive view leading to a common model for
2 interconnection that is not based on classification of carriers as
3 LECs, IXCs, CMRS providers, or ESPs.

4 BellSouth comments, FCC Docket No. 96-98 at 63.

5
6 Similarly, this Commission should implement a comprehensive cost-based pricing
7 system which does not discriminate between types of calls or carriers. Of course,
8 such a system requires that access charges be based on cost.

9
10 **Q. Are there operational efficiencies to be gained by non-discriminatory, cost-**
11 **based access charges?**

12
13 **A.** Yes. For BellSouth to enforce a price differential between "interexchange access"
14 and "local termination", BellSouth would need to require that all competitors adopt
15 the same definition of local calling *and* BellSouth would need to implement
16 auditing systems to correctly assess its charges. Such systems are not only
17 unnecessary, but they would cause both BellSouth and the entrant to needlessly
18 incur costs solely to accomplish an unreasonable result: the continued
19 discrimination between local and long distance calling.

20
21 **Q. Are there other ways that the Act's success depends upon cost-based access**
22 **rates?**

1 A. Yes. Cost-based access rates are needed for one of the principle means of local
2 competition -- local resale -- to be economically viable.

3

4 **Q. How do access charges affect the viability of local competition using local**
5 **resale?**

6

7 A. With local resale using wholesale services, BellSouth remains the access provider
8 even to the customers that have "left" and subscribe to a reseller. Because access
9 charges are priced above cost, BellSouth would retain substantial profits from a
10 customer even after it has lost its retail business. In effect, this means that the
11 reseller markets the relatively less profitable service, while BellSouth retains the
12 cream. This situation is somewhat analogous to agreeing with Gillette to market
13 its razor handles, while Gillette retains a monopoly on the blades. Sound
14 competition cannot proceed on this basis.

15

16 **Q. Are there other consequences of pricing access above its economic cost?**

17

18 A. Yes. In addition to the *new* problems created under the Act, the *old* problems
19 caused by the overpricing of access continue. To date, the effect of above-cost
20 access charges has principally been felt in the efficiency of carrier networks and
21 the calling behavior of consumers. Over the past decade, interexchange carriers
22 have made substantial investments in fiber optic transmission facilities. The full
23 utilization of these networks is artificially retarded by the high prices that local

1 telephone companies impose on long distance calling. These inflated prices
2 discourage both additional calling by customers and the introduction of innovative
3 new services that cannot overcome the threshold pricing barrier imposed by access
4 charges.

5
6 Even in the environment which predates the Act, the above-cost pricing of access
7 has negatively impacted the economy and consumers. Compound these problems
8 with the issues created under the Act -- no local-boundary competition, less local
9 entry, fewer service choices, and a perpetual bar on BellSouth's provision of
10 interLATA service -- and the reasons for immediate access reform mount. The
11 relevant question, therefore, is how can access rates be reduced?

12 13 **III. The Last Best Chance for Access Relief**

14
15 **Q. How are access rates regulated under Florida law?**

16
17 A. Network access service is regulated under a price cap mechanism that would
18 perpetuate the overpricing of this critical service. After the opportunity presented
19 by the Stipulation passes, the Florida statutory section governing access (section
20 364.163, Florida Statutes) would actually permit access rates to *increase* with the
21 rate of inflation.

22
23 **Q. Do you expect competitive pressures to force access rates towards cost?**

1 A. No. Most elements of switched access service -- particularly terminating access -
2 - are invulnerable to competitive pressures. With the exception of the local
3 transport component of switched access, the remaining rate elements for switched
4 access service (local switching, the CCLC and the RIC) are not subject to
5 competitive pressure because the interexchange carrier's switched access provider
6 will be the end-user's local telephone company -- even if the end-user has a choice
7 of local phone companies. These "non-competitive" access rate elements
8 comprise more than 95% of BellSouth's average switched access charge.
9

10 **Q. Is there evidence to support your contention that local competition will not**
11 **bid down access prices?**

12
13 A. Yes. There is growing evidence that entrant local telephone companies charge
14 access rates that either mirror, or are actually higher than, those of the incumbent
15 telephone company. For example, MFS has mirrored the incumbents' rates in
16 both Maryland and Georgia, City-Signal has mirrored Ameritech's access rates in
17 Michigan, and ACC-Syracuse actually charged access rates that were higher than
18 NYNEX.
19

20 **Q. If competition won't force access rates down, and Florida's price cap**
21 **provisions won't force access rates down, how can they be reduced?**

22
23 A. The Commission can use a portion of the final unspecified revenue reduction

1 provided for in the Stipulation to reduce BellSouth's access charges as
2 recommended in the Joint Proposal. I recognize that this would mean that access
3 reductions will receive a large share of the final reduction, but this is *only because*
4 access has provided a disproportionate share of BellSouth's profits since their
5 inception.

6
7 No one could have predicted -- and none did -- that Congress would enact
8 legislation that would so fundamentally change the telecommunications industry.
9 The need for access reform is far larger now than at the time the Stipulation was
10 negotiated and implementing only the minimum, specified reduction required by
11 the Stipulation (i.e., access levels in parity with December 1993 interstate rates)
12 is no longer acceptable.

13
14 **Q. What conditions existed at the time the specified access reductions in the**
15 **BellSouth Stipulation were approved?**

16
17 A. The basic objective of the access reductions specified by the Stipulation was parity
18 with interstate rate levels. There were two motivations behind the attempt to
19 achieve interstate parity. First, there was the economic motivation. High access
20 rates depress long distance calling. Because interstate access rates were below
21 intrastate, targeting intrastate rates towards interstate levels would bring them
22 marginally closer to cost, increase usage, and increase network efficiency.

23

1 The second motivation was administrative simplicity. Parity between interstate
2 and intrastate access rates eliminates incentives for carriers (or consumers) to use
3 access configurations which complicated the jurisdictional identification of traffic.
4 For these reasons, there was general industry consensus that interstate and
5 intrastate access rates should first converge and then, one would hope, trend
6 downward together.

7
8 **Q. Are these still valid concerns?**

9
10 **A.** In a sense, yes, but events have far outpaced the relevance of interstate parity. At
11 the time the Stipulation was signed, distinct toll and local markets existed. Within
12 the toll market, only one artificial boundary affected consumers and producers: the
13 inter/intrastate boundary.

14
15 Under the new federal Act, however, there is the potential promise of an
16 integrated toll/local market, where carriers compete, among other things, on the
17 basis of individually determined local calling areas. Consequently, in the time
18 since the Stipulation was signed, the target price for intrastate access has shifted
19 from the *interstate* price to the *interconnection* charge.

20
21 I mentioned at the beginning of my testimony that the novelty of long distance
22 companies requesting access reductions is long gone. This observation is both a
23 testament to the perseverance of the (soon to be formerly known as) long distance

1 industry and a telling indication of the seriousness of the problem. These
2 companies have patiently sought access relief for more than a decade; they agreed
3 to let pass any claim to the first two unspecified reductions implemented under the
4 Stipulation; and, even with the reduction sought here, access will still be seriously
5 overpriced.

6
7 This is the Commission's last opportunity to (even partially) correct this problem.
8 Under price cap regulation, the Commission's ability to affect retail rates is
9 seriously limited. The best way to protect consumers is to give them the means
10 to protect themselves: Choice. But assuring that consumers have choices requires
11 that other carriers have the ability to offer services that consumers desire.
12 Competition can protect *consumers*, but it will be many years before ubiquitous
13 network competition will protect *carriers* from the charges they must pay
14 BellSouth to use its network, and competition may never play a role in
15 determining the charge to terminate traffic to BellSouth's subscribers. Only the
16 Commission can establish cost-based charges, and only this last time under the
17 Florida law.

18
19 **IV. The CCLC and RIC Should Go First**

20
21 **Q. What specific pricing actions do you recommend?**

22
23 **A. The interstate parity *specified* by the Stipulation, and required under the Florida**

1 Act, should be achieved through reductions in the CCLC charge. As set out in
2 the Joint Proposal, \$35 million of the \$48 million in *unspecified* rate reductions
3 for 1996 should be used to eliminate the "residual interconnection charge", more
4 commonly known as the RIC, rate element.

5
6 **Q. Why should the CCLC be reduced to achieve the interstate parity specified**
7 **in the Stipulation?**

8
9 A. There are two reasons why this should be the rate element reduced to accomplish
10 the interstate parity required under the Stipulation. First, the CCLC element is the
11 rate most responsible for intrastate rates exceeding interstate rate levels. The
12 Table below compares the relevant interstate and intrastate rate levels for access
13 service (intrastate access transport rates were established separately by this
14 Commission after hearing and parity with their interstate counterpart is not a
15 policy objective).

16

1
2
3
4
5
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11
12
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14
15

Interstate/Intrastate Access Comparison

Rate Element	Interstate	Interstate	Florida	Interstate Deviation	
	12/94	Current	Current	12/94	Current
CCLC-Orig	\$0.010000	\$0.010000	\$0.010610	6.1%	6.1%
CCLC-Term	\$0.015850	\$0.011970	\$0.029270	84.7%	144.5%
Local Switching	\$0.008320	\$0.007550	\$0.008760	5.3%	16.0%
Interconnection	\$0.005230	\$0.004392	\$0.005159	-1.4%	17.5%

The specified reduction required under the Stipulation is intended to bring intrastate levels in parity with interstate rate levels. As the above Table shows, because the terminating CCLC is the access rate element that is most at odds with this obligation, the CCLC should be the rate element that is reduced to meet this goal.

1 Second, the CCLC rate element was originally created by the FCC, then copied
2 by the Florida Commission, so that BellSouth received the same revenues from
3 long distance services *after* divestiture as it had been receiving when it provided
4 long distance services itself. The net effect of this pricing policy has been to
5 depress the long distance calling of those who are most sensitive to price, to cause
6 consumers who make relatively more long distance calls to provide a subsidy to
7 those who do not, and to use IXCs to transfer money from the long distance
8 market to BellSouth.

9
10 Such social ratemaking may have been possible when there was a monopoly, and
11 may have even seemed reasonable when "heavy" long distance users were
12 businesses and "light" users were residential consumers. In today's culture, with
13 extended families and the proliferation of beepers, fax machines, cellular phones,
14 and home offices, artificially raising the cost of "long distance" calling raises more
15 complicated social questions. Moreover, before BellSouth is permitted to offer
16 interLATA services, this system must end. BellSouth cannot *both* impose an
17 inflated charge to extract a subsidy from the long distance market and compete in
18 that market directly.

19
20 **Q. What rate element should the Commission address with the *unspecified***
21 **revenue reduction?**

22
23 A. The Commission has already decided that the residual interconnection charge

1 should be eliminated. In the recent proceeding establishing interconnection terms
2 and conditions for United and GTE, the Commission concluded:

3
4 Although we are not eliminating the RIC in this proceeding, we do
5 not believe the long run public interest is served when all
6 competitive local carriers are collecting the RIC from IXCs. We
7 believe that *none of them* should collect it. The RIC should be
8 phased out as soon as possible in the course of the scheduled
9 switched access reductions required by Section 364.163(6), Florida
10 Statutes.

11 Order No. PSC-96-0668-FOF-TP at 26 (emphasis supplied). Notably, BellSouth
12 will be increasing, not reducing, its switched access prices under the terms of
13 section 364.163(6) after this proceeding. As a result, the Commission should
14 direct that the RIC should be eliminated here.

15
16 **Q. Should the Commission approve BellSouth's strategic zone pricing proposal?**

17
18 **A. No. Access is the most competitively significant, carrier-to-carrier service that**
19 **exists. Non-discrimination is essential in the pricing of BellSouth's carrier-to-**
20 **carrier services, and a strict cost-justification must underlie any pricing differential.**

21
22 The principal rate element that BellSouth proposes to geographically deaverage --
23 the RIC -- shouldn't even *exist*. With no cost justification for its existence, there

1 can be no justification for any differential between zones. BellSouth's proposal
2 is principally an attempt to manipulate a non-cost based element in its access
3 charges to maintain its market dominance.

4
5 Finally, the rate reductions mandated by the Stipulation are not intended to
6 promote BellSouth's interest; they were established as the solution to the
7 Commission's last investigation into BellSouth's overearnings. If BellSouth truly
8 feels competitive pressure to reduce its prices, then it should reduce its prices and
9 receive less revenue like any other competitive firm -- but it should not be
10 permitted to count these revenues against (and thereby evade) its *obligations* under
11 the Stipulation.

12 13 V. Summary

14
15 **Q, Please summarize your testimony.**

16
17 A. The Commission stands at the brink of a new world founded on the federal
18 Telecommunications Act of 1996. One of the key underpinnings of the Act, and
19 the competitive environment that it hopes to create, are cost-based rates for the use
20 of BellSouth's network by its rivals. For the full benefits of the Act to be
21 realized, access charges must be based on cost like all other carrier-to-carrier
22 charges. Without non-discriminatory charges, the entire industry will be locked
23 into BellSouth's local calling areas and one of the most significant benefits of a

1 competitive environment -- carriers fighting for market share through products
2 with differing calling areas -- will be lost (or, at the least, sharply reduced).

3
4 Although access reform is critically needed, the Commission is limited under the
5 Florida Act from establishing cost-based rates. Thus, this final disposition of
6 unspecified revenues under the BellSouth Stipulation is the last best opportunity
7 for the Commission to address this problem under Florida law.

8
9 The Stipulation *requires* BellSouth to reduce its access rates to interstate levels.
10 In addition, the Stipulation prevented long distance carriers from seeking
11 additional access relief until this time -- the final reduction required by the
12 Stipulation. No one could have predicted at the time the Stipulation was adopted,
13 however, how much more important access reform would be in the future than in
14 the past. The Commission should adopt the Joint Proposal and use a portion of
15 the unspecified reduction to eliminate the RIC, with the remainder implemented
16 as recommended by the proposal.

17
18 **Q. Does this conclude your direct testimony?**

19
20 **A. Yes.**

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Testimony of Joseph Gillan On Behalf of The Florida Interexchange Carriers Association has been furnished by hand delivery* or by U.S. Mail to the following parties of record, this 14th day of August, 1996:

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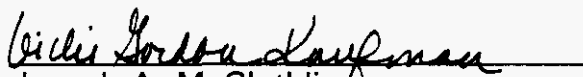
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