BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of Qwest Corporation's	)	**Docket No. 03-049-62**
Land Development Agreements (LDA)	)	
Tariff Provisions	)	

DIRECT TESTIMONY

OF

LAURA L. SCHOLL

FOR

QWEST CORPORATION

OCTOBER 4, 2004

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I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME, TITLE AND ADDRESS.

A. My name is Laura L. Scholl. I am employed by Qwest Services Corporation as the Utah Director of Regulatory Affairs for Qwest Corporation (Qwest).

Q. PLEASE REVIEW YOUR EDUCATION, WORK EXPERIENCE, AND PRESENT RESPONSIBILITIES.

A. As Utah Director of Regulatory Affairs, I am primarily responsible for all aspects of regulatory compliance for Qwest's regulated Utah operations. My duties include oversight of regulatory filings and advocacy, including presentation of testimony, as in this docket. I am also the primary liaison between Qwest and the Public Service Commission of Utah (Commission).

My education and work experience are detailed in Exhibit LLS-1.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I have testified before the Commission and filed testimony in numerous dockets, also detailed in Exhibit LLS-1

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony reviews the evolution of the LDA and the long history of its associated problems. It also addresses the attempts made by Qwest and the Commission to resolve those problems. Despite many years of earnest effort to

work collaboratively with all Option 2 contractors, Qwest's efforts have been frustrated. Qwest entered this proceeding hoping to resolve the problems with Option 2 rather than remove it, but continuing problems during the pendency of this proceeding have forced Qwest to conclude that the Option 2 process is irretrievably broken.

In the many years of attempts to make the process work, market conditions, the regulatory environment and customer choices have changed considerably. The Commission also completed an exhaustive cost proceeding which limits Qwest's cost recovery in many circumstances to a new and lower number than the current LDA cost "cap."

Qwest can identify no public policy interest that necessitates the continuation of Option 2. As a matter of fact, Qwest believes any requirement to continue to offer Option 2 violates many long-standing public policy principles such as reasonable cost recovery and cost-causer pays. Qwest can identify no end-user customer benefit as a result of Option 2. Much to the contrary, Qwest believes Option 2 impedes its ability to serve its customers. Qwest can identify no operational efficiency that is gained through Option 2, but the option does complicate many processes and prevent Qwest from effectively managing its network and its costs. Qwest can identify no legal or regulatory requirement fulfilled by Option 2, rather it causes expensive and protracted legal wrangling at the Commission and in the courts.

Since Qwest can identify no customer benefit, no legal obligation and certainly no shareholder interest served by Option 2, Qwest asks that it be allowed to remove Option 2 from its tariff.

Q. PLEASE IDENTIFY THE OTHER QWEST WITNESSES AND THE PURPOSES OF THEIR TESTIMONY

A. Additional testimony will be presented by Dennis Pappas, Director, Public Policy, on the mechanics of Land Development Agreements (LDA) and the difficulties associated with Option 2 of the LDA tariff. Richard Buckley, Director, Policy & Law, will present evidence on the investment per single family residence to demonstrate the appropriate dollar amount of the LDA tariff "cap" now in effect, using the cost approach approved by the Commission in Docket No. 01-049-85, to set unbundled network element rates in its orders issued May 5, 2003, July 25, 2003, January 27, 2004, and April 20, 2004.

II. PURPOSE AND HISTORY OF LAND DEVELOPMENT AGREEMENTS

Q. WHAT IS THE PURPOSE OF THE LDA TARIFF?

A. The LDA tariff provides the terms and conditions on which Qwest is willing to provision distribution facilities in, and provide service to, new permanent single-family residential housing developments. The tariff requires that Qwest and the developer enter into a land development agreement ("LDA"), which defines their

respective obligations regarding placement of facilities. The current iteration of the tariff was designed to avoid up-front placement costs for developers in all but the highest-cost areas of development (such as those with large lots, where extra cable and materials are required to serve the development). It was also designed to allow developers to choose between having Qwest place facilities and using self-help for that placement. The intent was to provide developers with greater flexibility and allow them to save money in high cost areas where there are up-front placement costs, if they could place facilities less expensively than could Qwest.

Q. PLEASE REVIEW THE HISTORY OF LDAS IN UTAH.

A. Beginning more than twenty years ago, LDAs required the developer to pay an up-front charge equal to the entire cost of the requested facilities. Over a five-year time frame, an annual refund was made based upon the number of new dwellings subscribing to telephone service. The developer was responsible for the trenching and backfill within the development or could pay a non-refundable charge to the Company for the trenching and backfill.

In 1985, a new LDA option for the developments <u>inside</u> the Base Rate Area was introduced. In lieu of the LDA, developers could choose a non-refundable option of paying an up-front $100 per subdivision lot charge. Trenching and backfill was done by the Company. Provisions applying outside the Base Rate Area did not change.

Q. PLEASE EXPLAIN TO THE COMMISSION WHAT THE BASE RATE AREA MEANS?

A. Historically, there were different rates for basic telephone service depending upon where a customer resided within an exchange area. One could envision it as concentric circles around the central office. The core circle closest to the central office ("CO") was the base rate area. Customers in that area paid a monthly base rate. Customers located in the surrounding circles ("zones") and areas outside of the base rate area (generally rural areas) paid incrementally higher monthly rates.

In the early 1990s, the differential rates for service in a zone or rural area were eliminated. The base rate, zone and rural area designations within an exchange continued only for the purposes of Qwest's construction tariff, which includes the LDA tariff.

Q. PLEASE CONTINUE YOUR REVIEW OF LDAS IN UTAH.

A. In 1991, a new LDA option for the developments <u>outside</u> of the Base Rate Area was offered. In lieu of the LDA, developers could choose to pay a non-refundable charge that was equal to 50 percent of Qwest's cost estimate to place facilities within the development. Trenching and backfill were done by the Company. The provisions relating to projects inside the Base Rate Area did not change.

Then, in 1997, the current LDA tariff became effective. The 1997 LDA removed the requirement that developers pay any up-front placement costs (whether inside or outside the Base Rate Area), as long as the placement was not in a particularly

expensive area (such as the areas mentioned above, with large lots, where additional cable and other materials are required to traverse the lot frontage, therefore increasing per-lot costs). Initially, Qwest agreed to absorb the cost of this placement as long as the per-lot cost did not exceed the distribution portion of its average exchange loop investment. After negotiations with the Home Builders' Association, Qwest increased that amount to 125% of the distribution portion of the average exchange loop investment.

Q. WHAT ARE THE CURRENT LDA PROVISIONS?

A. Under the current LDA tariff there are two options:

- Option 1 – Developer is responsible for the trenching and backfill for the distribution facilities within the development. The builder or premise owner is responsible for the trench and backfill for the service drop. Qwest engineers, designs, secures all materials, and provides the labor to place and test the distribution facilities within the development. The developer is only responsible to pay a non-refundable charge of the amount in excess of the per-lot cap (i.e. the distribution portion of the average exchange loop investment, times 125%, times the number of lots in the development) if the estimated cost exceeds the cap.

- Option 2 – Developer is responsible for the trenching and backfill for the distribution facilities within the development. The developer engineers and constructs the distribution facilities subject Qwest's review, inspection, testing and approval. Qwest will reimburse the developer's costs as identified in the LDA not to exceed the distribution portion of the average exchange loop investment (i.e. the same per-lot cap used in Option 1). The builder or premise owner is responsible for the trench and backfill for the service drop.

As previously indicated, Qwest's intent in adopting the new LDA was to make it easier for developers to arrange for facilities placement in new subdivisions and to generally eliminate developers' up-front placement costs. If through using this

self-help option developers could more easily coordinate their building schedules, they were allowed to do so as long as they conformed with the requirements of the tariff. Also, if there were situations where it would cost Qwest more than the per-lot cap amount to place facilities (thereby causing developers to incur the difference between $436.13 and the higher estimated cost for the project) and developers thought they could place the facilities themselves less expensively, they were able to do so under Option 2. However, Qwest never intended the cap to become a **default** price for all Option 2 jobs. Rather, it expected the cap to work the same under Option 2 as it worked under Option 1—Qwest would pay for the actual cost of the job (which would typically be less than 125% of the average loop investment), up to the cap amount. The 1997 tariff provided that costs would be agreed-upon between Qwest and the developer and incorporated in the LDA.

Q. WHAT HAPPENED AS A RESULT OF THE NEW OPTION 2?

A. The new option 2 tariff created an unintended consequence. A new “Option 2 contractor” industry sprang-up seeking business opportunities by designing and placing facilities directly for developers under Option 2. Under this system, Option 2 contractors establish a contractual relationship with the developers (but not with Qwest) and act as the developer’s defacto project manager with regard to the construction of telecommunication facilities. Many of these unregulated Option 2 contractors seek to maximize their profit margins by designing and constructing the bare minimum facilities necessary for a given development while at the same time attempting to charge Qwest the maximum amount allowed under

the tariff. As a result, shortly after the tariff was established, disputes began to arise over the interpretation of the per-lot cap specified in the tariff. Option 2 contractors sought to obtain the per-lot cap (then calculated at $436.13, based on a 1996 cost study) on every Option 2 job, even if (as was typical) the actual expenses associated with placing facilities on a job were well below the 125 percent cap.

Issues also arose about the amount of notice developers provided to Qwest under the tariff and about Qwest's ability to fully control the engineering and materials used on Option 2 jobs. The issues were particularly troublesome when prudent planning for growth would have caused Qwest to place larger facilities than might strictly be required for a particular phase of a subdivision. In this circumstance, Option 2 contractors sought additional money for larger cable than would be required to serve the single phase on which they were then working and in some cases fought against placing upsized cable regardless of whether Qwest paid additional costs for its placement.[1] In other instances, Option 2 contractors inappropriately placed multiple undersized cables to provide service—for example, placing four sets of 50-pair cable to service a development requiring 200-pair cable. Such engineering shortcuts saved Option 2 contractors placement costs and allowed them to increase profits, but left Qwest with increased problems (such as, in the example provided, having to worry about potential problems with

[1] Qwest does appropriately account for cable upsizing costs in its verifiable cost estimates. However, some Option 2 contractors seek not only to be paid the $436 per-lot cap, but also seek cable upsizing expenses as an additional cost.

four cables rather than one). On the timing issue, although the tariff called for 90 days notice (under either Option 1 or Option 2) prior to trenches being open, Qwest essentially never received anything close to that amount of notice. Some developers were able to get Option 2 contractors to place facilities (without Qwest's prior engineering approval or the entry of an LDA) with just a few days notice.

Q. HAVE THOSE ISSUES BEEN ADDRESSED BY THE COMMISSION?

A. The engineering, timing, and materials issues have not been addressed except insofar as by the Commission has stated that it believes most of such problems would be eliminated by compliance with the tariff. The cost issues have been addressed but only partially resolved. The Commission clarified the meaning of the tariff cap in Docket No. 98-049-33, rejecting the interpretation of Option 2 contractors who simply sought to charge $436.13 per lot as a flat rate. The Commission referred to this erroneous interpretation as one where "developers and/or their contractors have no incentive to restrain their extravagance unless and until the 125% of [the average exchange loop investment] is approached."[2] The Commission also noted, however, that the tariff did not specify that costs would be limited to those that Qwest would have incurred under Option 1 of the tariff. The Commission believed that the tariff required costs to be agreed-upon and incorporated in the LDA. It noted that since "Section 4.4(B)(6) [of the tariff]

[2] *See* Report and Order, *In the Matter of the Complaint of Silver Creek Communications vs. Mountain States Telephone and Telegraph Company, dba U.S. WEST Communications*, Docket No. 98-049-33 (April 30, 1999) at 5.

requires that costs be agreed upon at the inception of the agreement and incorporated in the LDA. . . . by implication, both developer and [Qwest] are required to furnish in good faith detailed, *verifiable* cost estimates on the request of the other party."[3]

In its Report and Order on July 15, 2003 in Docket No. 02-049-66, the Commission offered further clarification by stating: "Qwest argues that the cap incorporated into the LDA tariff has been interpreted by Complainants as the default price Qwest is to pay for every development. **That was not the intent of the tariff.** (emphasis added) The cap was just that, a cap, and if costs exceeded that amount, a developer is responsible for the additional costs. It was not designed to be the default price."

In that same Report and Order the Commission also stated: "To be good faith and verifiable, the cost estimates must be more than a quote from one of the Complainants or a similar company to do the job for the amount of the cap under the LDA tariff. With such estimates, costs would be agreed to up front and incorporated into an LDA between Qwest and the developer."

Q. WHAT HAS NOT BEEN RESOLVED BY THE COMMISSION IN ITS PRIOR DECISIONS?

A. As to Option 2 costs, the Commission did not specify what should happen if the parties, after exchanging verifiable cost estimates, are not able to reach agreement

[3] *Id*. at 6 (emphasis in original).

on the price and incorporate that price in the LDA. The Commission also did not specify what should happen if a party refuses to provide a cost estimate that would allow the parties to begin negotiating the price to be paid under Option 2.

Q. WHAT AUTHORITY DOES THE COMMISSION HAVE TO RESOLVE SUCH DISPUTES?

A. Although the Commission has jurisdiction over the interpretation of the tariff and over Qwest's compliance with the tariff, it does not have jurisdiction over the Option 2 contractors or developers, per se. In these proceedings, Qwest is the only party subject to potentially significant statutory consequences if it fails to comply with the Commission's orders. Some Option 2 contractors are apparently keenly aware of this fact, as some of them have aggressively disputed the Commission's jurisdiction to determine how much Qwest is required to pay for Option 2 jobs. To this day, certain Option 2 contractors continue to submit as their "verifiable cost estimates" (if they submit any estimate at all—which some do not) a demand to do each Option 2 job for the per-lot amount of $436.13. They continue to claim, despite the Commission's clear directions to the contrary quoted above, that the relevant "verifiable cost estimate" is the estimate of the developer, and the developer's estimated cost is whatever the Option 2 contractor charges for the job (which is almost always $436.13 per lot). In such circumstances, Qwest has little hope that a new Commission directive on the price to be paid for Option 2 jobs will fully solve the high-cost problem associated with Option 2. Commission directives on price have been ignored in the past.

As far as I can see, the only certain and effective recourse the Commission has over Option 2 contractors is to allow Qwest to refuse to do business with them or to modify its tariff by eliminating Option 2.

Q. ARE BOTH SOLUTIONS EQUALLY DESIRABLE?

A. No. While allowing Qwest not to do business with individual Option 2 contractors that do not comply with the tariff may help avoid the problem of Qwest having to deal with recalcitrant contractors, it does not resolve the problem of limiting Qwest's costs under Option 2 to a reasonable amount when parties cannot, in good faith,[4] agree on a price in the LDA.

It also does not resolve broader problems surrounding Option 2, including the engineering, materials, and timing issues mentioned above and the ongoing difficulties associated with Option 2 identified in the testimony of Dennis Pappas. Option 2 has generated one problem after another, in a long, expensive series of disputes that have often caused delays in establishing service to Qwest's customers. Option 2's burdens far outstrip any benefits it may provide (none of which redound to Qwest, in any event). Moreover, regardless of the tariff language, as long as Option 2 remains Qwest will never be able to fully control the process of its facilities placement. For example, if a developer chooses to disregard the timing provisions of the tariff and arrange for an Option 2 contractor

[4] Some Option 2 contractors do submit verifiable cost estimates that appear to have been prepared in good faith. Even these, however, typically include line items such as for "profit" that seem to always result in a cost estimate very near $436.13—when Qwest's own estimates for the same jobs are considerably lower.

to show-up and place facilities on a few days notice (notwithstanding the fact that Qwest has had no chance to review and approve engineering plans, to negotiate a price, or to enter an LDA) it does little good for Qwest to hold out the prospect of refusing to accept the facilities and begin providing service. Doing so only hurts customers. In some instances, Qwest has placed temporary facilities or provided cell phones to avoid being forced to choose between accepting facilities in such circumstances or denying customers phone service; but these obviously are neither desirable nor long-term solutions—they are simply more costs associated with Option 2.

In sum, Qwest regards a tariff modification as necessary at this point.

Q. WHAT OTHER ISSUES HAVE ARISEN AS ADDITIONAL OPTION 2 CONTRACTORS ENTERED THE BUSINESS?

A. The disputes have increased in number and variety. For example, as mentioned above:

- Some Option 2 contractors have insisted that they be paid the cap <u>and</u> be paid for the upsizing of facilities necessary for the other phases within the same development. The result is that Qwest ends up investing even more than the per-lot cap amount over the entire development. For example, if a 200-pair cable were necessary to serve an entire subdivision but the subdivision were developed in four equal phases, the Option 2 contractor may seek to place 50-pair cable in each individual phase—claiming that

size was sufficient for the project it was hired to do. Of course, Option 2 contractors typically have established relationships with particular developers, which means the same Option 2 contractor may very well do the work on all four phases of the subdivision. The contractor would seek extra payment for using the 200-pair cable in each phase, claiming that such cable was larger than the phase required—when if the developer had chosen to build the entire subdivision at one time the use of 200-pair cable would not have been upsizing at all. Thus, because a developer chose to build the subdivision in phases Qwest would incur further unnecessary expense (in addition to the Option 2 contractor inappropriately seeking $436.13 per lot) because the Option 2 contractor wanted extra payment for placing the cable size appropriate for Qwest's planning of the subdivision. This problem does not exist under Option 1 because Qwest simply places the cable size appropriate for the future for the area.[5] Placing too small a facility to serve future needs results in expensive reinforcements and duplicative placing costs.

- Some Option 2 contractors have disputed the amount that Qwest was willing to pay for the necessary upsizing of facilities not related to other phases within the development. Although Qwest was always willing to pay additional expenses for cable upsizing necessary to plan for other

[5] As previously noted, Qwest's verifiable cost estimates for Option 2 jobs include cost estimates for the appropriate cable size necessary to serve the remainder of the subdivision.

development not related to the developer's particular subdivision, Option 2 contractors have disputed the amount of such payment, claiming they should be entitled to payment for the amount it costs those contractors to purchase the larger cable rather than the amount for which Qwest could purchase the larger cable. This causes yet additional increased costs to Qwest.

- Some Option 2 contractors initially insisted that they be allowed to do town homes and multi-units as part of the LDA tariff. Thus, these contractors would have continued to seek $436.13 per lot, but for town homes where actual placement expenses are even lower than for single-family homes—increasing the disparity between actual placement costs and the costs Qwest would pay under Option 2. Qwest had to fight another Option 2 contractor complaint before the Commission to avoid this inappropriate extension of Option 2.

- At least one Option 2 contractor has continued to dispute that Qwest has provided them with appropriate engineering specifications for doing the work and has often challenged administrative changes that Qwest wanted to make in the LDA process. This has frustrated attempts to improve the process because Qwest couldn't simply focus on making the process the most sound from engineering and planning perspectives. Qwest also had to worry about potential litigation from the Option 2 contractor, which

impedes Qwest's ability to control the management of its facilities and creates a burden that would not exist but for Option 2.

The Commission, in its Report and Order in Docket No. 02-049-66, resolved the townhome and multi-unit issue. However, that proceeding did not resolve all of the problems. For example, as noted above, even though the Commission clearly stated that the cap was not the default price, some Option 2 contractors continue to insist they are entitled to the cap or a price very close to the cap as the default price. Also, some Option 2 contractors refuse to provide good- faith, detailed, verifiable cost estimates to Qwest. The bottom line is since Qwest made changes in the LDA process to comply with the Commission's order, such as requiring verifiable cost estimates, the problems and disputes have increased significantly.

Q. WHAT ATTEMPTS HAS QWEST MADE TO IMPLEMENT THE COMMISSION'S ORDER IN DOCKET NO. 02-049-66 AND WHAT HAVE BEEN THE RESULTS?

A. As a result of the Commission order, Qwest asked Option 2 contractors to comply with the Commission order that the cap was not the default price and to provide good faith detailed verifiable cost estimates.

Soon after the Commission's July 15, 2003 order, Qwest sent out notification to Option 2 contractors and developers that as of September 2003, Qwest would not continue to pay the cap as the default price and that it wanted to negotiate Option 2 costs based on good faith, detailed, verifiable cost estimates. Some Option 2

contractors complied, and Qwest has been able to agree on the price with these contractors. However, other Option 2 contractors resisted this change and there have been a number of disputes. For example, soon after Qwest sent out the letter, Qwest received a letter from an attorney representing at least two Option 2 contractors, demanding that Qwest retract its letter to the developers and threatening legal action against Qwest. One of these contractors later sued Qwest for tortious interference.

In general, Qwest's attempts have been met with great resistance from the Option 2 contractors. The responses from Option 2 contractors fall into four basic categories:

1. In some cases, Option 2 contractors are willing to accept Qwest's estimated cost. Since there is an agreement on the price, there has not been a need for Qwest to receive good faith detailed verifiable cost estimates from the contractors. There have been some conflicts over the upsizing of facilities.

2. Some Option 2 contractors have provided detailed cost estimates to Qwest but their estimated costs are at or very close to the cap for every project. They are not willing to accept Qwest's cost estimate and there have been disputes about the amount of detail that Qwest needs to provide in

its good- faith, detailed, verifiable cost estimate. There have been some disputes over the upsizing of facilities. Efforts to negotiate other possible solutions have not been successful. Qwest has entered into a stipulation with these contractors to pay Qwest's estimated cost, subject to true-up plus interest, if the Commission determines that Qwest should have paid more.

3. One Option 2 contractor has claimed the cap on every project but has not provided cost estimates of any kind. There have been disputes over the upsizing of facilities. Qwest has entered into a stipulation with this contractor to pay Qwest's estimated cost, subject to true-up plus interest, if the Commission determines that Qwest should have paid more.

4. One Option 2 contractor continues to insist that their verifiable cost estimate is simply the cap price, refusing to provide anything more. The contractor also disputes the amount of detail provided in Qwest's verifiable cost estimate. This is the contractor that has disputed the Commission's jurisdiction to set the price that Qwest should pay for Option 2, has sued Qwest in Third District

> Court to force Qwest to pay $436.13 per lot (plus costs for cable upsizing related to the same subdivision), and has sued Qwest for tortious interference. Qwest has entered into a stipulation with this contractor to pay Qwest's estimated cost, subject to true-up plus interest, if the Commission determines that Qwest should have paid more.

In sum, due to Qwest's attempts to comply with the Commission's order, it now is involved in another LDA-related complaint proceeding (Docket No. 04-049-06) and faces a multiple-count law suit in Third District Court.

Q. HAS QWEST PREVIOUSLY ATTEMPTED TO MODIFY THE LDA TARIFF?

A. Yes, due to problems in administering the LDA program, the fact that Option 2 contractors were seeking to charge the cap amount for every Option 2 job, and the fact that only two Qwest states were using the LDA approach, in 1999 the company proposed to replace the LDA tariff with the Provisioning Agreement for Housing Developments (PAHD) tariff in Docket No. 99-049-T28.

Under the proposed terms of the PAHD tariff, the developer would have been responsible for the trenching and backfill for the distribution facilities within the development. The developer, builder or premise owner would also have been responsible for the trench and backfill for the service drop and for placing the Company-provided conduit and/or service drop material. The Company would

engineer and construct the distribution facilities, with no self-help option for the developer. The developer would have only been responsible to pay a non-refundable charge of the amount in excess of a new revised cap (i.e. $576.41 per lot) if the estimated cost exceeded that cap.

After an evidentiary hearing, the Commission issued an order on May 26, 2000 approving the PAHD tariff. On July 3, 2000, the Commission granted reconsideration of its order and suspended the PAHD tariff. The Commission then reversed its original order and rejected the PAHD tariff on October 2, 2000, stating "that the difficulties identified with the LDA result not from the LDA itself, but the lack of compliance with the LDA."

Qwest made yet another attempt to address its concerns relating to LDAs on April 10, 2001. Qwest filed a revised PAHD tariff (Docket No. 01-049-T12) that would have provided Qwest would not pay more than its estimated costs, not to exceed the cap, for Option 2 LDAs. On May 9, 2001, the Commission suspended the tariff. On August 6, 2002, Qwest withdrew the tariff change request.

III. OPTION TWO SHOULD BE REMOVED FROM THE TARIFF

Q. DO TARIFFS IN OTHER QWEST STATES CONTAIN THE "OPTION 2" LDA PROVISION THE UTAH TARIFF INCLUDES?

A. No. Of the 14 Qwest states, 12 have only "Option 1". Colorado has Option 1 and an Option 2 which was significantly modified recently. After Option 2 was

introduced in Utah and Colorado, it quickly became evident that it was fraught with problems. To the best of my knowledge, Option 2 was never offered in the other 12 states.

Q. PLEASE DESCRIBE THE MODIFIED COLORADO OPTION 2.

A. Initially, the Colorado tariff was almost identical to the Utah tariff. However, as a result of a proceeding last year, the tariff includes an affirmative statement that "Qwest will reimburse the Developer/Builder the lesser of its costs or the Per Lot Cap adjusted for Developer/Builder provided trenching and backfill." There were also a number of other changes, many of which are not relevant to Utah. The LDA section of the Colorado tariff is found in Section 4.4 of the Exchange and Network Service Tariff.

Q. SHOULD OPTION 2 CONTINUE TO BE A TARIFF OFFERING IN UTAH?

A. No. As we have learned from experience in Utah and other states, this is not an offering that is necessary or provides any real benefit to Utah consumers. It has created ongoing disputes, expensive litigation and provides no real value to anyone except perhaps the developers, who get a project manager gratis in the person of the Option 2 contractors, and the Option 2 contractors who receive windfall profits at the expense of Qwest and its shareholders. The LDA tariff started as a voluntary offering. Qwest should be able to modify its offering

documents when they are not working well to best serve the needs of its customers and shareholders, without years of wrangling and legal expense.

Q. PLEASE DESCRIBE QWEST'S PROPOSED CHANGES TO ITS LDA TARIFF.

A. Qwest proposes to eliminate Option 2 of the LDA tariff. There are also a few clarifying changes being proposed to Option 1, such as better specifying the time-frames within which the parties should proceed to take the various steps necessary to complete an LDA and place the facilities. There are no changes being proposed to the Option 1 cap. A red-lined version of the changes is attached to the testimony of Dennis Pappas, as Exhibit 4.

Q. ASIDE FROM THE IMPLEMENTATION PROBLEMS, ARE THERE OTHER REASONS PROMPTING QWEST TO PROPOSE THESE CHANGES?

A. As discussed above, despite years of effort Qwest has been unable to persuade the Option 2 contractors to adhere to the administrative processes envisioned by the tariff or the Commission in its interpretations and related orders. But that is not the only factor driving Qwest's request. There are a number of policy and practical fairness issues, as well, including:

1. Option 2 isn't necessary for Qwest to provide timely service to its end-user customers;

2. Qwest is operating in a changed environment, with powerful competitive forces at work. Option 2 inhibits Qwest's ability to compete with other providers;

3. Qwest is no longer rate-of-return regulated; as a result it cannot recover any costs except through rates which the competitive market will bear. Any excessive costs, such as Option 2 payments at the cap, are ultimately borne by shareholders. It is unreasonable for Qwest to continue to be required to offer Option 2 for the benefit of developers when Qwest can't recover the associated costs;

4. In the competitive marketplace, the Commission has found that a reasonable investment cost for a single family dwelling is roughly $250, not the current cap of $436.13 (see the testimony of Dick Buckley);

5. Qwest is not a party to the agreements between developers and Option 2 contractors. It has no ability to protect its interests except through tariff changes – it has been unable to make changes it deems necessary despite more than 5 years of attempts;

6. As the Commission is well aware, there are many developments where Qwest has no presence because the developer has chosen to have a Competitive Local Exchange Carrier (CLEC) provide the service. Given the competitive nature of the telecommunications market, the LDA shouldn't even be in a tariff. At most, LDAs should be contained in a

price list which can be modified and become effective on five days notice. Once price-listed, any review would come after the changes were effective and the party challenging the change would bear the burden of proof;

7. Given that Qwest is no longer rate of return regulated, there is no justification to require Qwest to pay more than its own costs to the benefit of contractors and developers, especially given its recent announcement of a $700M loss in second quarter of 2004;

8. No other Utah telecommunications corporation or regulated utility has the same obligation to allow a third party (with whom it has no contractual relationship) to design and construct its distribution facilities;

9. The statutory charge of the PSC is to ensure just and reasonable rates and quality service for Utah telephone customers. There is no public service interest served by requiring Qwest to subsidize real estate developers or Option 2 contractors. Furthermore, the PSC has no ability to enforce its previous decisions with the Option 2 contractors.

Q. YOU MENTIONED THAT OPTION 2 IS NOT NECESSARY FOR QWEST TO PROVIDE TIMELY SERVICE TO ITS CUSTOMERS; WAS “OPTION 2” INTRODUCED TO ADDRESS HELD ORDER PROBLEMS IN UTAH?

A. No. However, there has been some confusion on that point. Despite claims to the contrary, Option 2 was introduced voluntarily by the company as part of an

initiative to simplify its LDA offering. At one point in time, the Commission's Administrative Law Judge made a passing reference that he understood that the Option 2 LDA was introduced by USWC as a means of alleviating a backlog of held orders. That statement was later retracted by the ALJ in his order in Docket No. 99-049-T28.

Q. DO DEVELOPERS NEED OPTION 2 TO PROVIDE TIMELY SERVICE TO HOME BUYERS?

A. No. Utah and Colorado are the only Qwest states with this option. Obviously developers in the other Qwest states are able to coordinate their construction and provide service to their home buyers without Option 2. It is also important to note that this stage of development should generally occur long before homes are ready for occupancy. Permanent power must be in place for homes to pass inspection. If developers can manage the process to ensure commercial power is available on a timely basis, they can certainly manage similar processes for telephone service.

Q. IS THERE ANY EVIDENCE THAT INDICATES OPTION 2 IMPROVES HELD ORDER RESULTS?

A. None that I can find. Qwest's held order results in Utah have been consistently excellent. The Utah service standard for held orders in R746-340-8 is "no more than 5 held orders per 1,000 New (N), Transfer (T), and Change (C) orders" at the end of each month. Qwest's results which are reported quarterly to the PSC have been far better than required by rule. For 2002 the statewide average was 0.75

held orders per 1000 NTC orders. In 2003 the results were 0.17 held orders per 1000 NTC orders and for the first six months of 2004, the results are 0.22 held orders per 1,000 NTC orders.

Furthermore, in areas of the state where there are no Option 2 contractors, which includes 12 wire centers, results have also been exceptional. In the four months between April and July of 2004, there has been only one held order associated with an LDA in those 12 wire centers. It is important to note that those wire centers serve some of the fastest growing areas of the state, such as Washington County, and the review was conducted during what is traditionally a busy construction season. The clear indication is that Qwest is able to provide timely service under Option 1 and that Option 2 does nothing to improve held order results. As a matter of fact, Option 2 disputes being addressed in a separate docket have actually caused held orders.

Q. ARE THERE ANY OTHER POTENTIAL SOLUTIONS THAT ARE ACCEPTABLE TO QWEST BESIDES ELIMINATING OPTION 2?

A. Not really, Qwest believes there is no public policy reason for it to be forced to continue to include Option 2 in its tariff. Furthermore, despite its best efforts it has been unable to make option 2 a viable, workable or cost-effective alternative.

However, Qwest is aware the Commission previously declined to allow Qwest to remove Option 2. Since that time competition has continued to increase and Utah customers have more choices than ever in a telecommunications provider.

Qwest's competitors are not burdened with a requirement that they accept facilities placed by persons with whom they do not have a contractual relationship and for prices beyond what they are willing to pay. This puts Qwest at a significant competitive disadvantage.

In the event the Commission is unwilling to eliminate Option 2 immediately, Qwest has three alternative recommendations. The first is that Option 2 be phased out over the next six months. This will allow developers and Option 2 contractors a window of time to modify their business plans and operations.

The second alternative is to adopt tariff changes that make it clear that Qwest is not obligated to pay more for facilities placed under Option 2 than for facilities placed under Option 1. This is similar to the PacifiCorp self-help approach which has already been approved by the Commission. Although Qwest believes Option 2 is no longer appropriate in the competitive telecommunications market, if the Commission requires Qwest to keep Option 2 in place, the Commission could adopt a policy that limits costs while ensuring that facilities are placed to meet Qwest's requirements. The payment to Option 2 contractors would be Qwest's estimated cost less its additional administrative costs associated with Option 2 such as engineering and job inspection. This would place the risks and burdens associated with excess Option 2 costs on the parties who obtain the benefits from Option 2—developers and Option 2 contractors. It would allow Option 2 contractors to either seek to place facilities less expensively than Qwest can (and

receive profit up to the amount of difference between their costs and Qwest's) or to market their services in such a way that developers are willing to pay the excess amount over Qwest's costs.

A third option would be to make it clear that under no circumstance should Qwest be required to pay more for Option 2 than the loop investment cost found to be just and reasonable by the Commission and ordered in the UNE loop cost proceeding, Docket No. 01-049-85. This, in effect, would not be a tariff modification except for removing the 125% element of the current tariff formula, since the current tariff calls for a cap of the distribution portion of the average exchange loop investment. The UNE loop cost is the current Commission-approved reflection of that investment. (The 1996 cost study led to the $348.90, which when multiplied by 125% gave the $436.13 cap.)

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The administration of Option 2 of the LDA tariff has become an unreasonable burden upon Qwest and should be eliminated. Despite dogged efforts neither Qwest nor the Commission have been able to induce the Option 2 contractors to work within the parameters of the tariff or the Commission's orders interpreting the tariff. Finally, Qwest believes the continuation of Option 2 cannot be justified by any public policy interest the Commission is charged with defending.

Qwest asks that the Commission move expeditiously to approve the proposed tariff changes and finally resolve these issues.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. It does.