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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of CLEAR WAVE COMMUNICATIONS, L.C., *et al.*, Complainants, vs. QWEST CORPORATION, Respondent.	Docket No. 04-049-06 **QWEST'S REPLY TO THE DIVISION OF PUBLIC UTILITIES**

Pursuant to the Notice of Schedule Change entered in this matter on November 23, 2004, Qwest Corporation ("Qwest") hereby respectfully replies to the Brief of the Division of Public Utilities ("Division Brief") submitted on December 2, 2004.

I. ARGUMENT

Qwest appreciates the effort by the Division to set out the background of the long, difficult history of LDA-related disputes, and appreciates the recommendation that significant changes should be made to the LDA tariff. Qwest also agrees with many of the Division's conclusions, including that the main issue in this proceeding may be "what happens when the parties do not reach a timely agreement and the project goes ahead without a contract"[1] and that a refusal to submit meaningful cost estimates should disqualify a party—such as SBS—from obtaining the cost recovery it seeks.[2]

Qwest files this reply to address one aspect of the Division Brief with which Qwest respectfully disagrees. On page 12 of its brief the Division suggests a possible solution whereby "if the Option 2 contractor provided a verifiable good faith cost estimate in a timely way and there is no issue as to betterments, Qwest should just pay the cost of the Option 2 contractor up to the cap."[3]

Qwest disputes this approach on two grounds: first, that the recommendation does not comport with the Commission's prior directives that costs be agreed upon and that developers make an "informed decision" between the cost estimate of Qwest and that of the Option 2 contractor; and second, it does nothing to prevent the "maximum bid[ding] fair to become the minimum," where because the Option 2 contractor determines its own costs, the price to Qwest will always be at or very near the tariff cap.[4]

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[1] Division Brief at 10.

[2] *See id*. at 12.

[3] *See id*.

[4] *See* Report and Order, Docket No. 02-049-66 (July 15, 2003) ("2003 Order") at 8 ("If Qwest and developers complied with this directive, before the LDA was entered into, and provided up-front, good faith detailed, verifiable costs estimates, then a developer could make an informed decision as to whether to have Qwest, or another party such as [an Option 2 contractor], install the facilities."); Report

A. Payment Of Whatever The Option 2 Contractor Demands, Where That Contractor Has Submitted A Good Faith Cost Estimate, Would Not Comply With Prior Commission Directives.

As Qwest noted in its response brief filed on December 1 in this docket ("Qwest Response"), in the 1999 Order the Commission held that the tariff's reference to the cap amount only "makes sense if it is assumed that the costs have been identified, **agreed upon**, and incorporated in the LDA."[5] Such agreement on costs was the "the only interpretation fair to both parties and consistent with the public interest . . . ."[6] Thus, Qwest and the developers were instructed to provide verifiable cost estimates upon the request of the other party so that they could reach agreement on cost and incorporate that agreement in the LDA.[7] As the Qwest Response also noted, the Commission has made clear that the purpose of the verifiable cost estimates is to allow the developer to make "an informed decision" between Option 1 and Option 2,[8] which in this context of submitting cost estimates can only mean a decision between the price agreed upon by Qwest and the price offered by the Option 2 contractor. Otherwise, if Qwest were simply required to pay whatever the contractor demands, up to the tariff cap amount, the developer would have nothing at stake with regard to cost and would not need to make any decision on price at all, informed or otherwise.

The recommendation in the Division Brief that when an Option 2 contractor submits a good faith, verifiable cost estimate Qwest should pay whatever that estimated cost happens to be does not comport with these prior Commission directives that costs be agreed upon and that

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and Order, Docket No. 98-049-33 (April 30, 1999) ("1999 Order") at 5 (rejecting the situation where "Developers and/or their contractors have no incentive to restrain their extravagance unless and until the [tariff cap] is approached, and thus the maximum bids fair to become the minimum.").

[5] 1999 Order at 5 (emphasis added).

[6] *Id.* at 6.

[7] *See id.*

[8] *See* 2003 Order at 8.

developers make an "informed decision" on price. This is particularly true when Qwest's own cost estimates are substantially lower than the cap amount, or substantially lower than the Option 2 contractor's cost estimates.

B. Payment Of Whatever The Option 2 Contractor Demands, Where That Contractor Has Submitted A Good Faith Cost Estimate, Would Still Unfairly Result In Costs At Or Near The Tariff Cap.

The other problem with the Division's recommendation is that because it allows Option 2 contractors to determine their own costs, it would likely result in a price at or near the tariff cap amount on every job. A review of the costs estimates submitted by Clear Wave, East Wind, and Prohill demonstrates this point. These companies, all managed by Steve Allen, are some of the most reasonable of the Option 2 contractors. Qwest is not aware of any basis to dispute the good faith nature of their cost estimates—which is to say, Qwest does not doubt that the costs they identify in their estimates are the actual costs they intend to pay. However, in the cost estimates from these companies for the jobs at issue in this complaint, the lowest per-lot estimated cost was $404.61, submitted by East Wind for the Kings Court Estates project. This estimate is still **93%** of the maximum per-lot cost allowed in the tariff (assuming $436.13 as the maximum, rather than the current $311.90[9]).[10] In other words, the **lowest** cost Clear Wave, et al., seek is still almost at the tariff maximum. The estimated costs submitted by these companies for the other projects at issue in this case all hover at, above, or just below the tariff cap.[11]

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[9] *See* Direct Testimony of Dick Buckley, Docket No. 03-049-62 (Oct. 4, 2004) at 5 (explaining that the tariff formula currently yields a per-lot cap of $311.90).

[10] A copy of East Wind's estimate for the Kings Court project is attached as Exhibit A. Qwest's own cost estimate for the Kings Court project (attached hereto as Exhibit B) was $319 per lot, or 73% of the old tariff cap amount.

[11] *See, e.g.*, estimates for West Jordan Meadows Phase 3, attached hereto as Exhibit C ($15,947--$469.04 per lot); Oquirrh Park Phase 3A, Plat B, attached hereto as Exhibit D ($17,665.05--$420.60 per lot); Eagle Pointe Phase 5, attached hereto as Exhibit E ($9,227.14--$461.36 per lot); Santaquin Meadows Phases C&D, attached hereto as Exhibit F ($6,077.01--$405.13 per lot); Liberty Villages, attached hereto as Exhibit G ($23,079.81--$419.63 per lot); Sunset Fields, attached hereto as Exhibit H ($13,586.69--

A review of the cost estimates for these companies shows why. In the first jobs from the fall of 2003, after Qwest began to demand verifiable cost estimates, Clear Wave, et al., detailed their material and labor costs, and then tacked-on a 25% profit margin that put their costs very near the tariff cap.[12] This profit margin, which had no basis in the tariff, struck Qwest as simply a method to back-in to obtaining something close to the cap amount for every job—it could obviously be manipulated so that whatever the hard costs were, the profit margin could change to make up the difference between those costs and the cap amount. Qwest disputed the profit margin, noted that Qwest's own cost estimates already had excess costs in the loaded labor rate (i.e., costs beyond what an Option 2 contractor should expect to pay for its own labor) that could serve as a profit to an Option 2 contractor, and declined to agree to pay the line item for profit.[13]

After only a few jobs, the line item for profit disappeared from the Clear Wave, et al., cost estimates. However, even with this elimination of 25% of the costs, the overall cost estimates from these companies did not go down. Instead, they changed their labor rate from $180 per lot to $255 per lot, and the cost estimates continued to hover at or around the tariff

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$452.89 per lot); Eagle Pointe Phase 9, attached hereto as Exhibit I ($11,638.08--$447.62 per lot); Diamond Summit Phase 4, attached hereto as Exhibit J ($24,071.08--$454.17 per lot). In contrast, Qwest's own corresponding cost estimates for these jobs, which are attached as Exhibits K-Q, were $380.35 per lot; $339.57 per lot; $374.30 per lot; $332.73 per lot; $321.44 per lot; $397.45 per lot; $338.40 per lot; and $389.77 per lot. The last of these estimates, $389.77 for Diamond Summit Phase 4, does not have a written cost estimate because no estimate was requested by East Wind.

[12] *See* estimates for Country View Phase 2 and West Jordan Meadows Phase 3, attached hereto as Exhibit R.

[13] *See* Letter from Qwest to Meridian (October 6, 2003) attached hereto as Exhibit S. It should be further noted that nothing prevents Option 2 contractors from making an additional profit through charging developers the difference between what Qwest is reasonably willing to agree to pay and the amount the Option 2 contractors seek. It continues to strike Qwest as odd that Option 2 contractors argue so strenuously about the need to retain Option 2 for the sake of developers, yet according to Option 2 contractors (who argue that Option 2 would vanish if Qwest's costs were limited—i.e., that developers would refuse to pay the difference between Qwest's costs and the costs of the Option 2 contractor) apparently no developer is willing to actually pay anything for this purportedly valuable option.

cap.[14] Again, Qwest does not dispute that these are the actual costs Clear Wave, et al., began to pay. However, the point should be obvious that merely because a cost estimate is "good faith" and "verifiable" in the sense of being accurate and provable, does not mean that the amount is reasonable nor that the Option 2 contractors will not ensure that their expenses stick very close to the tariff cap. Indeed, if Option 2 contractors can force Qwest to pay whatever amount they demand merely by submitting detailed, verifiable cost estimates, those estimates will serve little more use than the "estimates" SBS submits to do every job for the cap amount. Either approach will lead to a result where the "maximum bids fair to become the minimum"[15] through the Option 2 contractor's ability to determine its own costs. Either approach will ignore the Commission's prior directives that costs be agreed upon and that developers make an informed decision on price. In short, if the Division's recommendation were adopted so that the Option 2 contractor's cost estimate controlled, it could be expected that essentially every Option 2 cost estimate would come in at a price extremely close to the cap amount. That was not the intent of the tariff nor the intent of the Commission's prior orders on Option 2 costs.

[14] *See, e.g.*, Exhibits D, F-J.

[15] *See supra* note 4.

II. CONCLUSION

For the reasons stated above, the Commission should not adopt the recommendation of the Division that when an Option 2 contractor submits a good-faith, verifiable cost estimate, Qwest should simply pay that estimated amount.

RESPECTFULLY SUBMITTED: December 20, 2004.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **QWEST'S REPLY TO THE DIVISION OF PUBLIC UTILITIES** was served upon the following by electronic mail, on December 20, 2004:

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