

ANNUAL REPORT
OF THE
PENNSYLVANIA
OFFICE OF SMALL BUSINESS ADVOCATE
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INTRODUCTION

The Office of Small Business Advocate (“OSBA”) was established “within the Department of Commerce,” now the Department of Community and Economic Development (“DCED”), by the Small Business Advocate Act, Act 181 of 1988, 73 P.S. §§399.41 et seq. (the “Act”).

The OSBA is administratively included within DCED. However, the Act specifically provides that the Secretary of DCED is not in any way responsible for the policies, procedures or other substantive matters developed by the OSBA to carry out its duties under the Act.

The Act directs the OSBA to represent the interests of small business consumers of utility services before the Pennsylvania Public Utility Commission (the “PUC”), in the courts and before comparable federal agencies. For purposes of the Act, a small business consumer is defined as “a person, sole proprietorship, partnership, corporation, association or other business entity which employs fewer than 250 employees and which receives public utility service under a small commercial, small industrial or small business rate classification.”

Business and residential customers generally have a similar interest in keeping a proposed utility rate increase as small as possible. However, their interests may conflict on the issue of rate structure (in other words, the percentage of a rate increase to be borne by each particular category of customer). In a rate structure dispute, the Office of Consumer Advocate’s principal client is the residential ratepayer. Furthermore, the large industrial and commercial customers frequently have their own attorneys and expert witnesses. As a result, there was a fear prior to Act 181 that a disproportionate share of any rate increase would be allocated to small business customers because they usually could not afford their own representation. The legislature sought to alleviate that fear by creating the Office of Small Business Advocate.

Under the Act, the Small Business Advocate is granted broad discretion concerning whether or not to participate in particular proceedings before the PUC. In exercising that discretion, the Small Business Advocate is to consider the public interest, the resources available to support the activities of the OSBA and the substantiality of the effect of the particular proceeding on the interests of small business consumers. The OSBA has been selective in intervening in PUC proceedings in order (1) to avoid duplicating work already being done by other governmental participants in the regulatory process, and (2) to focus its efforts on those matters where the interests of small business customers are likely to be different from those of the utility's other customer classes.

Because of the office’s success on utility matters, additional duties were assigned to the OSBA as part of the reforms enacted in 1993 to Pennsylvania’s Workers’ Compensation Act. Article XIII of that revised statute, 77 P.S. §§1041.1 et seq., authorizes the Small Business

Advocate to represent the interest of employers in proceedings before the Insurance Department that involve filings made by insurance companies and rating organizations with respect to the premiums charged for workers' compensation insurance policies sold in Pennsylvania. Those duties require the Small Business Advocate to review the "loss cost" adjustment filings that are made each year by the Pennsylvania Compensation Rating Bureau and the Coal Mine Compensation Rating Bureau of Pennsylvania.

The current budget for the Office of Small Business Advocate is \$1,157,000. That budget is funded by assessments on utilities and on workers' compensation insurers, in proportion to the office's expenses in relation to each group. At the present time, utility company assessments account for about 85% of the budget and insurance company assessments for about 15%.

The OSBA's present employee complement consists of seven persons, including four attorneys (the Small Business Advocate and three Assistant Small Business Advocates) and three support staff personnel.

After being nominated by Governor Edward G. Rendell and confirmed by the state Senate, William R. Lloyd, Jr., began serving as Small Business Advocate on November 24, 2003.

PUC ACTIVITIES

The OSBA participates before the PUC in major base rate cases, purchased gas cost cases, telephone rate rebalancing cases, and other non-rate proceedings that have a significant impact on small business consumers. The following is a summary of some of the most significant cases:

Electric Highlights

Duquesne POLR Rates

Under the 1996 "electric choice" law, the local utility is required to function as the "provider of last resort" unless the PUC designates some other entity to fill that role. That means that the utility is responsible for generating, or buying, electricity for all of its customers who choose not to buy from an alternative supplier. The utility is also required to generate, or buy, electricity for those customers whose alternative suppliers fail to deliver. The utility is permitted to charge customers "prevailing market prices" for the electricity.

On December 9, 2003, Duquesne Light Company ("Duquesne") asked the PUC for approval of a plan for "provider of last resort" service to retail customers for the period from January 1, 2005, to December 31, 2010. Under the plan, Duquesne would buy electricity for its Large Commercial and Industrial customers on the open market through an auction process. In contrast, Duquesne would buy electricity for its small business and residential customers from a

coal-fired power plant which would be owned by an affiliate of Duquesne. The overall monthly bill for small business and residential customers would increase by about 7 % in January 2005 and by about 5.9 % in January 2008.

The OSBA has intervened in this proceeding (docketed at No. P-00032071) in an effort to protect the interests of Duquesne's small business customers. This case is pending before the PUC.

Gas Highlights

National Fuel Gas Distribution Corp.

On April 16, 2003, National Fuel Gas Distribution (ANFGD@) filed for a general increase in base rates, i.e., rates for the recovery of costs of service other than purchased gas costs. The request was docketed at R-00038168.

NFGD's filing requested an overall rate increase of \$16.5 million (over a 17 percent increase in revenue for non-gas costs). Of that \$16.5 million, NFGD proposed to recover \$700,000 from the Company's small commercial customers.

In response to the NFGD filing, the Office of Consumer Advocate (AOCA@) proposed to assign a total of \$1.86 million of the overall increase to NFGD's small commercial customers. Under OCA's proposal, small commercial customers would have experienced a rate increase of more than \$1 million above what NFGD had recommended in its original filing.

The case was ultimately resolved through the settlement process. The settlement agreement allowed NFGD a \$3.5 million rate increase (3.6 percent of non-gas costs). During the settlement negotiations, the OCA attempted to assign \$400,000 of the \$3.5 million to NFGD's small commercial customers. However, the OSBA ultimately prevailed on this issue; as a result, none of the \$3.5 million rate increase was imposed on NFGD's small commercial customers.

Telephone Highlights

Verizon Competitive Services

On July 1, 2002, Verizon Pennsylvania Inc. filed a petition seeking the PUC's determination that Verizon's provision of business telecommunications services to customers with annual telephone bills less than \$10,000 is "competitive" under then Chapter 30 of the Public Utility Code. The Petition was docketed at P-00021973. Under a prior PUC decision, services to business customers with annual bills of \$10,000 or more had already been declared to be "competitive."

The designation of a service as “competitive” permits a telephone company to establish the price for the service, set the terms and conditions of the service, and discontinue the service without PUC approval. The “competitive” designation is an alternative to the traditional regulatory oversight of the rates and earnings by the PUC.

The OSBA opposed Verizon’s petition on the grounds that the statutory conditions necessary to declare telecommunications services “competitive” under Chapter 30 were not met for the business customer class generating annual total billed revenue less than \$10,000. The Administrative Law Judge (in a Recommended Decision on January 30, 2003) agreed that Verizon had not met its burden of proof and denied the Verizon petition in its entirety. Verizon filed exceptions to the Recommended Decision and sought to have the PUC overrule the ALJ and grant the petition. The OSBA filed reply exceptions opposing Verizon’s petition.

On August 13, 2003, the PUC ruled that the Verizon petition should be denied. The PUC found that Verizon’s approach of treating all business customers with annual bills of less than \$10,000 the same (regardless of where they were geographically located within the Commonwealth) was detrimental. As an alternative, the PUC suggested that, instead of an “all or nothing” approach, the parties should consider a geographical approach where the less dense areas of the service territory would not be declared “competitive” but the more dense areas could be declared “competitive” if they otherwise satisfied the statutory criteria.

On August 29, 2003, Verizon filed a Petition for Reconsideration or Modification requesting reclassification of business telecommunications services as “competitive” in only density cells 1, 2, and 3.¹ The OSBA opposed this petition on the grounds that the evidence did not support the request. On January 29, 2004, the PUC denied Verizon’s petition.

Although there is often competition to serve large businesses because of the volume of revenue that can be captured from just one business, there often is no real competition to serve small businesses. The result of the PUC’s ruling is that all competitive local exchange carriers of telecommunications services can compete with Verizon to sell services to small business customers with annual total billed revenue less than \$10,000. However, Verizon must provide those services under traditional regulation. The idea is to maintain certain consumer protections for small business customers and to assure that they are not adversely impacted if their only real alternative is to buy the services from Verizon.

Sprint/RTCC Access Charges

¹ Density cells progress from most dense to least dense. Density cell 1 represents roughly downtown Philadelphia and downtown Pittsburgh. Density cell 2 represents the rest of Pittsburgh and Philadelphia. Density cell 3 includes suburban Philadelphia, Harrisburg metropolitan area, Lancaster, Reading, etc. Density cell 4 includes Johnstown, Altoona, Williamsport, etc., and the rural areas.

On December 16, 2002, the United Telephone Company of Pennsylvania (ASprint@), the Rural Telephone Company Coalition (ARTCC@), the OSBA, the PUC's Office of Trial Staff (AOTS@), and the Office of Consumer Advocate (AOCA@) filed a Joint Proposal for Access Charge Reductions (AJoint Proposal@), pursuant to the generic access charge investigation at M-00021596. The PUC approved the Joint Petition on July 10, 2003.

Companies providing long distance telephone service must pay access charges to the local telephone company in order to transmit messages over the local telephone company's network. The Joint Proposal caused the access charges of Sprint and the RTCC companies to be reduced.

A reduction in access charges generally results in less revenue for local telephone companies. As a result, they frequently respond by increasing rates for local exchange service. Significantly, the Joint Proposal required that any increase in the business rates necessitated by the reduction in the access charges must be equal to any increase in the residential rates on a dollar-for-dollar basis. Historically, rates for small business customers have often been increased by more than the rates for residential customers.

Verizon Access Charge

The *Global Order* and the *Merger Order* are the foundations of this proceeding. The *Global Order* was entered by the PUC on September 30, 1999. The *Global Order* reduced access charges of all local telephone companies operating in Pennsylvania. The *Merger Order* was entered by the PUC on November 4, 1999. It allowed Verizon Pennsylvania, Inc. ("VZ-PA," f.k.a. Bell Atlantic Pa., Inc.) and Verizon North Inc. ("VZ-N," f.k.a. GTE North, Inc.) to merge their corporate structures if the entities agreed to certain conditions. One of the conditions was to reduce VZ-N's access charges (that were considerably higher than VZ-PA's) to achieve parity throughout the service territories of VZ-N and VZ-PA.

On March 21, 2002, AT&T filed a formal complaint against VZ-N (docketed at C-20027195) requesting a reduction in VZ-N's access charges to the levels of VZ-PA, as required by the *Merger Order*. On December 30, 2002, VZ-PA and VZ-N filed a joint petition proposing an access charge reduction plan to which OSBA and various other parties objected. The VZ-PA and VZ-N joint plan to reduce access charges was proposed on a phased-in basis. Step one was to reduce access charges in the VZ-N territory to the levels of the VZ-PA territory and to increase basic local exchange service rates by up to \$3.00 on a weighted average rate basis through December 31, 2003. The effect of step one was a \$40 million reduction in access charges and a corresponding increase in local exchange rates. The second step was to reduce both the VZ-N and VZ-PA access charges by an additional \$40 million and to increase basic local exchange service by up to \$2.50 on a weighted average rate basis for 2004. The basic local exchange service rates would be capped at the step two level (no greater than a weighted average rate of \$18 for one-line residential customers and the comparable level for one-line business customers) and remain at that cap for a minimum of three years or through December 31, 2006. Lastly, for those business

customers that have contracted service with VZ-PA or VZ-N, the contract would prevail so that the contracting customers' basic local service exchange rates would not be raised.

The OSBA argued in opposition that the increase to business customers was indefinite and, thus, could not be found to be just or reasonable.

During the proceeding, VZ-PA, VZ-N and the Office of Consumer Advocate reached a settlement agreement. Under the agreement, access charges would not be reduced beyond the first step and residential customers' weighted average increase for basic local exchange service would be no more than \$1.00, with residential rates capped at that level for a minimum of three years. Other parties (excluding OSBA) either agreed with the settlement or expressed no opposition. The OSBA opposed the settlement because the increase to business customers would remain uncertain and, thus, could not be found just and reasonable. Additionally, the OSBA considered it unreasonable to require the rest of the business community to make up for the revenue VZ-PA and VZ-N would lose because of access charge reductions for business customers who have contracts with either of the two utilities.

This matter is still pending before the Commission.

Water and Wastewater Highlights

Pennsylvania-American Water Company

The OSBA actively participated in a case (docketed at No. R-00027982) in which the Pennsylvania-American Water Company petitioned the PUC to approve a surcharge to collect the cost of wastewater system improvements implemented between base rate cases. The OSBA contested the legality of this surcharge. The OSBA also pointed out that expenses for system improvements should not be viewed in a vacuum because customer and usage growth, a decline in financing costs, and cuts in other expenses could offset at least part of the expenditures for system improvements. When the PUC approved the surcharge, the OSBA intervened in the appeal to the Commonwealth Court taken by the Office of Consumer Advocate ("OCA").

This case is pending before the Commonwealth Court.

York Water Company

On January 24, 2003, the York Water Company (AYork Water@) filed for a general increase in base rates. The request was docketed at R-00027975.

York Water=s filing requested an overall rate increase of \$2.81 million (a 13.7% increase in total revenue). Of that \$2.81 million, York proposed to recover \$528,000 from the Company=s

small commercial customers. In response to the York filing, the Office of Consumer Advocate (AOCA@) filed testimony that proposed to assign a total of \$811,000 of the overall increase to York Water=s small commercial customers, an increase of over 50 percent above what the Company had recommended in its original filing.

The case was ultimately resolved through the settlement process. The agreement allowed York Water a \$1.725 million (8.4%) increase in rates. Through the intervention of the OSBA, the small commercial customers of York Water were ultimately responsible for only \$322,000 of the total \$1.725 million increase.

2003 PUC Cases

As previously noted, the OSBA participates in major rate increase cases before the PUC, the annual Gas Cost Rate cases for Pennsylvania's 11 largest gas companies and a number of other formal proceedings that come before the PUC each year involving disputes over the kinds of services made available to, or the prices charged to, the small business customers of electric, gas, telephone, water and wastewater utilities. A list of the PUC cases in which the OSBA entered its appearance during calendar year 2003 follows:

ALLTEL (PSI Report)
Docket No. P-00032047

Buffalo Valley Telephone Company (Revenue-neutral rate rebalancing filing)
Docket No. R-00038351

Buffalo Valley Telephone Company (PSI/SPI and Exogenous event filing)
Docket No. P-00032032 and P-00981428

Columbia Gas of Pennsylvania, Inc. (2003 GCR Proceeding)
Docket No. R-00038245

Commonwealth Telephone Company (Exogenous event - PSI/SPI filing)
Docket No. P-00032020

Conestoga Telephone (PSI/SPI and Exogenous event filing)
Docket No. P-00032033 and P-00981429

Conestoga Telephone (Revenue-neutral rate rebalancing filing)
Docket No. R-00038350

Denver & Ephrata d/b/a D&E Telephone Co. (Revenue-neutral rate rebalancing filing)

Docket No. R-00038352

Denver & Ephrata d/b/a D&E Telephone Co. (Exogenous event filing)
Docket No. P-00032034 and P-00981430

Duquesne Light Company (POLR III Proceeding)
Docket No. P-00032071

Equitable Gas Company (2003 GCR Proceeding)
Docket No. R-00038166

Equitable Gas Company (Universal Service Funding Mechanism Proceeding)
Docket No. P-00032070

Frontier Telephone Companies (Modification of inflation offset filing)
Docket No. P-00951005

Investigation - Obligations of Incumbent Local Exchange Carriers to
Unbundle Local Circuit Switching for the Enterprise Market
Docket No. I-00030100

Investigation - Obligations of Incumbent Local Exchange Carriers to
Unbundle Network Elements
Docket No. I-0003099

Investigation Development of an Efficient Loop Migration Process
Docket No. M-00031754

National Fuel Gas Distribution Corporation (2003 GCR Proceeding)
Docket No. R-00038101

National Fuel Gas Distribution Corporation (Base Rate Proceeding)
Docket No. R-00038168

North Pittsburgh Telephone (Revenue-neutral Filing)
Docket No. R-00038087

North Pittsburgh Telephone (Exogenous Event Filing)
Docket No. P-00032038 and P-00981437

PECO Energy Company (2003 GCR Proceeding)

Docket No. R-00038409

Pennsylvania-American Water Company (Facility Protection Charge)

Docket No. R-00027983

Pennsylvania-American Water Company (Wastewater Collection System Charge)

Docket No. R-00027982

Pennsylvania-American Water Company (Base Rate Proceeding)

Docket No. R-00038304

Pennsylvania Suburban Water Company (Base Rate Proceeding)

Docket R-00038805

Peoples Natural Gas Company (2003 GCR Proceeding)

Docket No. R-00038170

PFG Gas Inc and North Penn Gas (2003 GCR Proceeding)

Docket No. R-00038412

PG Energy (2003 GCR Proceeding)

Docket No. R-00038410

Philadelphia Gas Works (2003 GCR Proceeding)

Docket No. R-00038173

Philadelphia Gas Works (remand M-00021612 - Senior Citizen Discount)

Docket No. P-00032061

Sprint d/b/a The United Telephone Company (Individual Case Basis Availability)

Docket No. R-00038610

T.W. Phillips Gas & Oil Company (2003 GCR Proceeding)

Docket No. R-00027888

UGI Utilities Inc. (2003 GCR Proceeding)

Docket No. R-00038411

Verizon Pennsylvania, Inc. (Consolidated Loop Cost Proceeding)

Docket No. R-00038028

Verizon Pennsylvania, Inc. (Wholesale Rate for Resale)

Docket No. R-00038516

Vineyard Oil & Gas Co. v. NFG (Complaint Against NFG)
Docket No. C-20039935

West Penn Power Company (Qualified Rate Order Proceeding)
Docket No. R-00039022

York Water Company (Base Rate Proceeding)
Docket No. R-00027975

Small Business Consumer Outreach

The Office of Small Business Advocate also handled individual small business consumer problems in 2003.

The following are some examples of OSBA assistance to small businesses:

The OSBA assisted a small business in the Philadelphia area that encountered an \$18,000 bill for past electric usage due to a metering problem. The originally requested amount was reduced to \$7,000.00 and the customer was provided with a payment plan for that amount.

The OSBA assisted a small parish in western Pennsylvania that encountered a problem with the gas line to the property while doing some renovations in preparation for a church picnic. The parish was told by the gas company that the problem would be addressed in approximately three to six weeks. Due to OSBA action, the problem was resolved in less than a week.

The OSBA assisted a small business that was relocating two miles from its present location. The business made arrangements with its telephone provider to relocate the service to the new address, only to find out that the relocation did not take place on the agreed upon date. The service was ultimately transferred to the new location.

The OSBA assisted several small businesses that encountered charges on their telephone bill for internet service they did not request. Ultimately, those internet charges were taken off their telephone bills.

The OSBA assisted a small business that encountered the omission of its business information from the White Pages Directory. OSBA informed the business of its rights and explained the process which would facilitate a resolution.

WORKERS' COMPENSATION ACTIVITIES

OSBA's workers' compensation duties involve a review and evaluation (with the assistance of the economist and the actuary retained as consultants for these cases) of the "loss cost"² filings that are submitted to the Insurance Department each year by the Pennsylvania Compensation Rating Bureau ("PCRB") and the Coal Mine Compensation Rating Bureau of Pennsylvania ("CMCRB").

PCRB Filing

The OSBA recommended a decrease of 6.18% to statewide industrial loss costs in lieu of the 2.41% decrease proposed by the PCRB to take effect on April 1, 2003. The OSBA also recommended changes in the computation of the PCRB's Hepatitis B Surcharge. The Insurance Department adopted the OSBA's recommendations with regard to the Hepatitis B surcharge.

On November 25, 2003, the PCRB made its annual loss cost filing for rates to go into effect on April 1, 2004. The OSBA filed comments on December 31, 2003, recommending an increase of only 0.41% in lieu of the 3.32 % increase proposed by the PCRB. This matter is pending before the Insurance Department.

CMCRB Filing

The OSBA recommended a 3.0 % decrease for coal mine coverage as opposed to the 9.7% increase proposed by CMCRB to go into effect on April 1, 2003. The Insurance Department accepted the OSBA's recommendations with regard to the traumatic and federal occupational disease components of the filing. This resulted in a final overall increase in loss costs of 4.0 % (less than half of the increase proposed by CMCRB).

In December 2003, the CMCRB proposed loss cost rates to go into effect on April 1, 2004. The OSBA submitted recommendations to the Insurance Department that the CMCRB alter its methodology for determining individual class loss costs. The purpose of OSBA's recommendations is to reduce the volatility employers see from year to year in their insurance rates. In the coal mining industry, workers' compensation insurance is the second highest expense (after payroll) faced by employers. This matter is pending before the Insurance Department.

² The "loss cost" portion of a workers' compensation premium reflects the cost of paying wages for employees whose injuries prevent them from working. The "loss cost" portion of the premium also reflects the cost of medical care for injured workers.

OSBA STAFF

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