UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Bay Gas Storage Company, Ltd. Docket Nos. PR04-9-000
PR04-9-001

ORDER ON TARIFF SHEETS AND COMPLIANCE FILING

(Issued June 2, 2005)

1. On March 9, 2004, Bay Gas Storage Company, Ltd. (Bay Gas) filed in Docket No. PR04-9-000 a petition for approval of rates for firm and interruptible transportation services under section 311 of the Natural Gas Policy Act of 1978 (NGPA).[1] In an order issued on August 6, 2004, the Commission instituted a Staff Panel proceeding to assist in the review of Bay Gas's proposed rates and to encourage the parties to settle the issues in dispute.[2] A Staff Panel was convened on September 21, 2004. As discussed below, the Commission by this order accepts Bay Gas's tariff sheets proposing to roll in the costs of its newer Whistler spur facilities. This order benefits customers by setting maximum transportation rates that reflect the service provided by the pipeline.

Background

2. Bay Gas began operations of its original facilities in 1994.[3] The 22-mile 20-inch diameter pipeline runs due south from Bay Gas's McIntosh underground storage facilities to its Salco Station, which is located north of Mobile, at Axis, Alabama. The system intersects with two interstate pipelines: Florida Gas Transmission Company (Florida Gas) near the pipeline's midpoint and Gulf South Pipeline Company, LP (Gulf South) near Salco Station. Bay Gas's original facilities also interconnect at Salco Station with Mobile Gas Service Corporation (Mobile Gas), which is a local distribution company affiliate of Bay Gas. In 2002, Bay Gas constructed its Whistler spur facilities. Those facilities are made up of a 24-inch diameter pipeline running generally southwest from Salco Station

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[1] 15 U.S.C. § 3371 (2000).

[2] *Bay Gas Storage Co., Ltd.*, 108 FERC ¶ 61,161 (2004).

[3] *Bay Gas Storage Co., Ltd.*, 66 FERC ¶ 61,354 (1994) (approving market-based rates for original facilities).

17.5 miles to Whistler Junction, where there is an interconnection with Gulf South and Mobile Gas.

3. Alabama Power Company (Alabama Power) owns an electric generator, known as Plant Barry, which is located on Bay Gas's original facilities, four miles north of Salco Station. Alabama Power is a subsidiary of Southern Company Services, Inc. (Southern), and Southern acts as its agent to purchase natural gas and obtain transportation of that gas to Plant Barry.[4] In 1999, Alabama Power entered into a contract with Bay Gas for firm transportation service of up to 82,000 MMBtu per day on Bay Gas's original facilities, from Salco Station to Plant Barry. Southern administers that contract on behalf of Alabama Power. That contract is at a fixed, discounted rate, and has a remaining term of 14 years.

4. Gulf South has a contract with Bay Gas for firm transportation service on the Whistler spur facilities. Gulf South uses that capacity to transport up to 82,000 MMBtu/day for Alabama Power from Whistler Junction to Salco Station. Alabama Power then uses its own contract with Bay Gas to transport the gas received off the Whistler spur facilities from Salco Station to Plant Barry. The Gulf South contract with Bay Gas for service on the Whistler spur facilities has a remaining term of about 7 years. Gulf South's service over the Whistler spur facilities on behalf of Alabama Power uses less than half the capacity on the Whistler spur facilities. In Docket PR01-10-000, Bay Gas stated that the Whistler spur facilities eventually will reinforce Bay Gas's storage service to Mobile Gas by connecting Mobile Gas with Bay Gas at a second location (at Whistler Junction) besides the interconnection at Salco Station.

5. Before this rate case, Bay Gas had separate transportation rates for service on each set of facilities. On March 9, 2004, as supplemented on April 9, 2004, Bay Gas sought approval of rolled-in rates for firm and interruptible transportation services on all of its facilities, both the 17.5-mile Whistler spur facilities and the 22-mile original facilities,[5] under NGPA section 311.

6. On April 12, 2004, Southern requested clarification, stating that Bay Gas's filing was silent on how shippers with receipt and delivery points only on the older pipeline will access receipt points on the newer Whistler spur facilities, and the rate they will pay for such access. Southern asked the Commission to clarify that, if the rates to be paid by shippers on the older pipeline are to include the costs of the formerly incrementally-

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[4] Southern Motion to Intervene and Request for Clarification at 3.

[5] *See Bay Gas Storage Co., Ltd.*, 97 FERC ¶ 61,020 (2001) (approving rates for Whistler spur facilities); 99 FERC ¶ 61,263 (2002) (approving rates for non-Whistler spur facilities).

priced Whistler spur facilities, then those shippers—including Southern/Alabama Power—should be given flexible point rights throughout the system.

7. On April 19, 2004, Bay Gas answered Southern's request for clarification, stating that there are no subsidy issues raised by rolling in the costs of the newer Whistler spur facilities: the rates paid by shippers on the original facilities under their existing contracts do not include costs for newer facilities. Bay Gas stated that Southern does not pay rates under its existing contract that include the newer facilities' costs. Instead, Southern's contract rate is discounted substantially from the maximum tariff rate, according to Bay Gas. Bay Gas stated that Southern today enjoys the same contract rights and duties that it enjoyed before the instant rate filing. Bay Gas argued that nothing has changed for Southern.

8. Bay Gas also argued that Southern's request incorrectly would extend interstate pipeline flexible receipt and delivery point policy to NGPA intrastate pipelines providing interstate transportation. Requiring intrastate pipelines to comply with that policy, Bay Gas averred, could make it unduly burdensome to participate in interstate markets, contrary to the intent of the NGPA. Rather, Bay Gas stated that it will negotiate NGPA intrastate pipeline service rates with all customers.

9. On May 7, 2004, Southern filed additional comments, arguing that Bay Gas has the burden of showing that its proposed rates meet the "fair and equitable" statutory standard.[6] Southern stated that some of the policies adopted for interstate pipelines may be equally applicable to intrastate pipelines and the Commission must consider these policies in determining whether to apply any of the Order No. 636 requirements to specific intrastate pipelines.[7] Southern contended that one such policy is that shippers should not be required to pay for services or facilities that they do not or cannot use.[8]

10. According to Southern, Bay Gas proposes to depart from its existing practice of charging the costs of the Whistler spur facilities to only those shippers using those facilities and to include the costs of the newer facilities in the rates applicable to the shippers on the original facilities. While Bay Gas stated that its proposal provides another option for shippers on the original pipeline to access gas supplies, Southern contended that this is a hollow promise, for Southern stated that Bay Gas admitted that any access by existing shippers to any such supplies via the Whistler spur facilities will

[6] Southern May 7 Comments at 3 (citing 15 U.S.C. § 3371(a)(2)(B)(i) (2000), which states that rates "shall be fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service.").

[7] *Id.* at 3 (citing *ANR Pipeline v. FERC*, 71 F.3d 897 (D.C. Cir. 1995)).

[8] *GulfTerra Texas Pipeline, L.P.*, 106 FERC ¶ 61,184, at P 24 (2004).

require a contract amendment with new rates that must be presumed to be higher than existing rates. Southern added that the fact that an intrastate pipeline is discounting its rates does not justify including improper charges in the maximum interstate transportation rate.[9]

11. Southern stated that the Commission could fulfill this duty by finding that Bay Gas had not carried its burden to show that its rates are fair and equitable because its maximum rates would include costs of facilities that shippers cannot use. However, Southern does not seek this remedy, but rather suggests that the availability of secondary rights to all receipt and delivery points on the Bay Gas system, including those accessed by the Whistler spur facilities, would be a fair way of accommodating Bay Gas's proposed roll-in.

12. On May 24, 2004, Bay Gas responded to Southern's additional comments. Bay Gas stated that its proposal does not change Southern's existing contract rate or service on the original facilities; that no Bay Gas customers are adversely affected by the proposal; that no contract rates increase; that no contract services decrease; and that no customer would pay for the same costs twice. Nothing in its NGPA compliance rate petition changes any aspect of Southern's contract on Bay Gas's original facilities, according to Bay Gas; nothing has changed.

13. Bay Gas reasoned that, because no costs for those subsequent, newer Whistler spur facilities were or conceivably could have been involved in Southern's earlier contract on the original facilities, Southern's recommendation that the Commission might add receipt and delivery point flexibility on the newer facilities to Southern's continuing, pre-existing contract on the original facilities lacks a factual basis. Bay Gas reiterated that the Commission exempted intrastate pipelines from the interstate pipeline flexible receipt and delivery point policy.[10]

14. Bay Gas underscored that contract integrity requires Southern to pay for the services it uses. It distinguished the precedent cited by Southern, explaining that in *GulfTerra* the Commission required the unbundling of gathering rates because including gathering costs (of which Bay Gas has none) in transportation rates disadvantages shippers purchasing gas off-system since they only need a separate transportation rate and not a gathering rate as well. Bay Gas stated that in *GulfTerra* the Commission concluded that all customers would still be able to use the entire system, but would not be required

[9] Southern May 7 Comments at 4 (citing *GulfTerra*, 106 FERC ¶ 61,184 at P 25; noting that the Commission's duty is to assure that maximum rates are fair and equitable).

[10] Bay Gas May 24 Answer at 5 (citing Order No. 636, FERC Stats. & Regs. ¶ 30,939, at 30,407 n.89; Order No. 636-B, 61 FERC ¶ 61,272, at 61,992 & n.26 (1992)).

to pay for services they do not use. Bay Gas explained that certainly the converse is also true on Bay Gas's system; namely, that customers must pay for the services they would use.

15. On June 29, 2004, Bay Gas filed an offer of settlement. Bay Gas stated that it submitted the offer on behalf of itself and the Commission staff, that it was the result of compromise and hard bargaining, and that it resolved the issues of the proceeding. On July 16, 2004, Southern filed comments opposing the offer of settlement. On August 6, 2004, the Commission issued an order instituting a Staff Panel proceeding.

16. On September 21, 2004, a Staff Panel was convened in order to permit parties an opportunity to present oral views, data, and arguments in accordance with NGPA section 502(b). The Staff Panel requested that Bay Gas file certain additional information. The requested information included a summary of all of Bay Gas's contracts with its customers, including the level of firm and interruptible service provided under those contracts, as well as the cost of service information.

17. On October 14, 2004, Bay Gas responded to the Staff Panel's data requests. However, pursuant to section 388.112 of the Commission's regulations, 18 C.F.R. § 388.112 (2004), Bay Gas requested privileged treatment of certain transportation service agreement information.[11] Bay Gas also sought privileged treatment of the overall amount of its revenues from discounted rate contracts, which was used in determining its discount adjustment.[12] Bay Gas contended that public disclosure of this information could violate section 17 F of its General Terms and Conditions (GT&C), which limited disclosure of the terms of any Storage or Transportation Service Agreement. Bay Gas also contended that such disclosure could cause competitive harm to Bay Gas and its other shippers.

18. In its October 28, 2004 initial brief following the Staff Panel, Bay Gas contends that such roll-in more accurately reflects how the Bay Gas system is operated. Bay Gas states that the roll-in will recognize the fact that the newer Whistler spur facilities act in conjunction with the original pipeline. Secondly, Bay Gas states that the roll-in will reflect the additional flexibility that the Whistler spur facilities bring to the system. Bay Gas explains that both the original and the newer Whistler spur facilities allow gas to

[11] Bay Gas sought privileged treatment with regard to the length of each contract, the maximum daily transportation quantity under each contract, and the individual contract rates. Bay Gas also sought privileged treatment for the names and volumetric contract data of certain storage customers. The transportation contract information at issue is in Attachment 1 to Bay Gas's data response. The storage contract information is in Attachment 2.

[12] The discount adjustment information is contained in Attachment 3, Schedule I-1.

flow in both directions; the bi-directional flow capability of the Whistler spur facilities adds overall flexibility to the system as a whole. Thirdly, Bay Gas contends the roll-in will provide enhanced reliability to the overall system because of the interconnection with Gulf South and Mobile Gas at Whistler Junction. Fourthly, Bay Gas argues that, since the total mileage of the system is small and having one rate for all facilities will eliminate the need for Bay Gas to make two separate filings every three years, the roll-in makes sense to promote administrative efficiency. Finally, Bay Gas states that there are no subsidy issues raised by the roll-in of the Whistler spur facilities, and that no existing firm customers' rates will increase as a result of the roll-in proposal.

19. Bay Gas also states in its initial brief and the attached response to Southern's May 7, 2004 comments that it incorporates as Attachment 2, as well as in its November 5, 2004 reply brief, that intrastate pipelines are exempt from Order No. 636 flexible point policy.[13] Bay Gas states that it relied on this exemption, and that requiring intrastate pipelines to comply with the policy would increase the burden for intrastate pipelines to participate in interstate markets, contrary to the intent of the NGPA.[14]

20. Southern, in its October 28, 2004 initial brief, argues that Bay Gas has not justified roll-in of the costs of the Whistler spur facilities. Southern contends that roll-in of the cost of the Whistler spur facilities is inconsistent with the Commission's 1999 *Policy Statement concerning Certification of New Interstate Natural Gas Pipeline Facilities* (1999 Pricing Policy Statement),[15] which generally requires that expansion facilities be priced incrementally so that existing shippers are not required to subsidize the expansion. Southern states that Bay Gas's justification for the roll-in falls apart when examined, that the asserted benefits to existing customers are too nebulous and general.[16] Southern also states that roll-in is inconsistent with the fair and equitable test of section 311 of the NGPA. In light of the burden of showing that the proposed rates meet the fair and equitable statutory standard, Southern explains that some of the policies adopted in Order

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[13] Bay Gas Initial Brief at 7 and Attachment 2 at 5 (attaching Answer to May 7, 2004 Comments); Reply Brief at 2 (citing *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation under Part 284 of the Commission's Regulations; and Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol*, Order No. 636, 57 Fed. Reg. 13,267 (Apr. 16, 1992), FERC Stats. & Regs. ¶ 30,939, at 30,407 n.89; *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272, at 61,992 & n.26 (1992); *EPGT Texas Pipeline, L.P.*, 99 FERC ¶ 61,295, at 62,252 & nn.21-22 (2002); Staff Panel Tr. 8-10).

[14] Bay Gas Initial Brief, Attachment 2 at 5.

[15] 88 FERC ¶ 61,227 (1999), 90 FERC ¶ 61,128 (2000), *reh'g*, 92 FERC ¶ 61,094 (2000).

[16] Southern Initial Brief at 6.

No. 636 for interstate pipelines may be equally applicable to intrastate pipelines. One such policy, Southern states, is that shippers should not be required to pay for services or facilities that they do not or cannot use.[17] Southern concludes that the Commission could simply deny the roll-in proposal because it fails to comply with the Commission's policies and the NGPA's fair and equitable standard. Alternatively, Southern posits that the Commission could condition roll-in of the Whistler spur facilities upon Bay Gas providing access on at least a secondary firm basis by all interstate shippers under their existing contracts to all receipt and delivery points on the Bay Gas system.

21. On February 14, 2005, the Commission directed Bay Gas to make public certain of the information for which Bay Gas requested privileged treatment and to remove section 17 F from its GT&C as contrary to Commission policy. On February 22 and 28, 2005, Bay Gas submitted respectively (1) revised redacted Attachment 1 and 3 responses to the Staff Panel's September 21, 2004 data requests and (2) a revised page 18 of its GT&C removing section 17 F, in compliance with the February 14, 2005 order.

Discussion

22. For the reasons discussed below, the Commission accepts Bay Gas's proposal to roll in the costs of the Whistler spur facilities and charge a single rolled-in rate for service on both the original facilities and the Whistler spur facilities. However, the Commission finds that Bay Gas's proposed return on equity is too high. The Commission otherwise approves Bay Gas's proposed cost of service and rate design volumes.

Rolled-in Rate Proposal

23. The Commission's current policy concerning rolled-in vs. incremental rates on interstate pipelines is set forth in our 1999 Pricing Policy Statement. Under that policy statement, the Commission changed the focus of its rolled-in versus incremental rate policy so that the primary goal is to achieve efficient pricing signals to expansion shippers and existing pipeline customers, while remaining within the pipeline's revenue requirement. Under this new policy, when an interstate pipeline project is first certificated, the Commission requires that existing shippers not be required to subsidize the expansion. This generally means that expansions will be priced incrementally so that expansion shippers will have to pay the full costs of the project, without subsidy from the existing customers through rolled-in pricing. This will help ensure that the market finds the project viable, because either the expansion shippers or the pipeline must be willing to fully fund the project. However, subsequently, when a pre-expansion shipper's existing contract expires it could be required to pay a higher rate than its existing vintage rate. This would occur where: (1) the pipeline is fully subscribed; and (2) there is a

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[17] *Id.* (citing *GulfTerra*, 106 FERC ¶ 61,184 at P 24).

competing bid higher than the pre-expansion rate. In addition, the Commission suggested rolled-in rates could be approved before the expiration of current contracts if the facilities are needed to improve service for existing customers, the increase in rates is related to improvements in service, and raising existing customers' rates does not constitute a subsidy of an expansion by existing customers.

24. While the 1999 Pricing Policy Statement addressed the rolled-in rate issue in the context of interstate pipelines regulated under the NGA, its underlying rationale applies to intrastate pipelines regulated under the NGPA with equal, if not more, force. Unlike interstate pipelines, which must file for Commission approval of expansions under NGA section 7, intrastate pipelines do not need any Commission authorization for expansions. Thus, it is all the more important for intrastate pipelines to be priced in a manner that achieves efficient price signals to expansion shippers as to the cost of the expansion. Requiring shippers on an expansion by an intrastate pipeline to pay the full costs of the project, without subsidy from the existing customers through rolled-in pricing, will help ensure that the market finds the project viable.

25. In this case, rolling in the costs of the Whistler spur facilities produces a lower maximum rate for service on Bay Gas's original facilities, than if service on the Whistler spur facilities continued to be priced on an incremental basis. Based on the cost of service holdings in the next section, if Bay Gas's rolled-in rate proposal were rejected, the maximum rates for service on the original facilities would be $1.5991 per MMBtu for firm transportation-only service, and $0.0526 per MMBtu for interruptible transportation-only service**.** However, rolling in the costs of the Whistler spur facilities produces maximum rates of $1.3682 per MMBtu for firm transportation-only service, and $0.0450 per MMBtu for interruptible transportation-only service**.** Thus, Bay Gas's rolled-in rate proposal does not require shippers on the original facilities to subsidize the Whistler spur expansion. This is particularly true for shippers with existing contracts on the original facilities, since all such shippers pay fixed, discounted rates for the terms of their current contracts. Accordingly, the Commission approves Bay Gas's proposal to roll in the costs of its Whistler spur facilities.

26. Finally, Southern contends that, if Bay Gas's rolled-in rate proposal is accepted, Bay Gas should be required to allow shippers with contracts for service on the original facilities to schedule service on the Whistler spur facilities, through the use of flexible receipt and delivery point rights. However, Bay Gas is correct that, as an intrastate pipeline, it need not offer its shippers flexible receipt and delivery point rights. The Commission has exempted intrastate pipelines from the requirements of Order No. 636, including its flexible receipt and delivery point policy.[18] Thus, we will not require Bay Gas to permit shippers with contracts for service only on Bay Gas's original facilities,

[18] Order No. 636-B, 61 FERC ¶ 61,272 at n.26. *See GulfTerra,* 99 FERC ¶ 61,295, at 62,252 (2002).

such as Southern/Alabama Power, to use the Whistler spur facilities on a secondary basis. Moreover, since the existing shippers on Bay Gas's original system are not being subjected to a rate increase as a result of the approval of rolled-in rates, the Commission sees no inequity in the fact they are not receiving flexible receipt and delivery points on the new facilities.

Cost of Service Issues

Revenue Requirement

27. The rate base as proposed in Bay Gas's March 9, 2004 filing includes Gross Plant, Accumulated Depreciation, Depletion and Amortization, Working Capital, and Accumulated Deferred Income Taxes for both the original and the Whistler spur facilities. Our review indicates that Bay Gas has adequately supported all rate base items. The total directly assigned transportation rate base for the original facilities is $14,150,937, and the directly assigned rate base for the Whistler spur facilities is $12,581,928. Based on a review of the cost of service items in Bay Gas's response to the Staff Panel's data request, the Commission accepts the Operation and Maintenance (O&M) expense for the original and the Whistler spur facilities of $922,110 and $136,441, respectively. The O&M expense includes an allocation of Administrative and General (A&G) expenses using the Kansas-Nebraska Method (K-N).[19] The K-N method, whereby A&G costs are allocated on the basis of direct labor ratios and plant ratios, is the preferred methodology used by the Commission. Therefore, we approve Bay Gas's use of this method.

28. In its petition Bay Gas also proposes annual depreciation expenses which are calculated by multiplying the depreciation rate by the total depreciable plant.[20] Bay Gas's net plant amount represents 83 percent for the original facilities and 94 percent for the Whistler spur facilities. The proposed depreciation rates can be converted into a remaining life of nearly 30 years for both systems. We find the stated remaining life for the facilities is reasonable and consistent with recent Commission orders addressing depreciation issues.[21] Consequently, the Commission finds that Bay Gas's proposed depreciation rates are reasonable. Accordingly, we accept the proposed depreciation rates. Additionally, our review of the cost of service items included in Bay Gas's

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[19] *Kansas-Nebraska Natural Gas Co.*, 52 FPC 1691, 1721-22, *reh'g denied*, 54 FPC 923 (1975), *aff'd*, 534 F.2d 277 (10th Cir. 1976).

[20] *See* Bay Gas's October 14 Data Responses, Response 3 of 4.

[21] For example, in *AES Ocean Express, LLC*, 105 FERC ¶ 61,030 (2003), the Commission accepted the company's proposal to use a 25-year life for supporting depreciation expense in its cost of service proposal.

submittal indicates that the rate of return, which affects the Tax Allowance expenses, needs to be adjusted, as discussed below.

Rate of Return

29. Bay Gas's March 9, 2004 filing used the year-end 2003 capital structure of Bay Gas's parent, EnergySouth, Inc. (EnergySouth), which is 50.91 percent equity and 49.09 percent debt. Bay Gas requested a return on equity of 14 percent and a debt cost of 8.69 percent. In response to the Staff Panel's September 21, 2004, Question 4 of 4, Bay Gas states that its proposed 14 percent return on equity is consistent with the range of equity returns historically allowed by the Commission for similar pipelines. The response states that the analysis does include a study following the Commission's preferred two-stage Discount Cash Flow (DCF) methodology used in pipeline rate cases.[22]

30. We find that the 14 percent rate of return on equity sought by Bay Gas is too high, as discussed below. Moreover, both the equity return calculation and the related capital structure in the March 9, 2004 filing are based on stale data. Accordingly, the Commission will reject the proposed rate of return and will develop a rate of return based on the record evidence. Based on the most recent capital structure and debt cost of Bay Gas's parent, EnergySouth, we find 10.39 percent to be an appropriate equity return to be allowed Bay Gas.

31. To derive a market-based estimate of the cost of equity to Bay Gas, we used the two-step version of the DCF methodology, where the cost of equity, k equals $(D(1+0.5g)/P)+g$, where D is dividends paid, and g is the investor-expected growth rate. As Bay Gas has no publicly traded common stock, which is a required P input for the DCF formula, we calculated the cost of equity using the same proxy group that was used by Bay Gas to calculate the requested 14 percent equity return in Schedule F of the March 9, 2004 filing. This proxy group consisted of four pipelines that remain from a group the Commission used as a proxy for the risks of natural gas pipelines in *HIOS*.[23] The four pipelines in the proxy group were Equitable Resources, Inc.; Kinder Morgan, Inc.; National Fuel Gas Supply Corporation; and Questar Pipeline Company.

32. Our DCF analysis produced a zone of reasonableness for equity returns of 8.82 percent to 13.43 percent, with a median of 10.39 percent. We find 10.39 percent to be an appropriate equity return to be allowed Bay Gas. Because EnergySouth appears to be the financing entity for Bay Gas's long-term debt since it guarantees debt, we would apply the 10.39 percent equity return to the most recent capital structure and debt cost of EnergySouth. As of December 31, 2004, the capital structure of EnergySouth included

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[22] *See High Island Offshore System, L.L.C.*, 110 FERC ¶ 61,043 (2005) (*HIOS*).

[23] *Id.*

45.58 percent long-term debt and 53.72 percent common equity. EnergySouth's weighted cost of debt on September 30, 2004, was 8.37 percent. The total after-tax cost of capital for Bay Gas would be 9.40 percent, compared with 11.40 percent in Bay Gas's filing.

33. In its March 9, 2004 filing, Bay Gas's DCF computation yields a zone of reasonableness of 10.6 percent to 15.1 with a median of 12.9 percent. As supported for its filed-for 14 percent equity return, Bay Gas claims that, "Bay Gas's risks indicate that a return higher than the median and average of the proxy group would be appropriate." In finding 10.30 percent to be an appropriate equity return to be allowed Bay Gas, we follow the Commission's guidance as set forth in *Transcontinental Gas Pipeline Corporation*, Opinion No. 414-A.[24] Specifically, we find that Bay Gas's claims of greater-than-average risks are not adequate to support an equity return above the median for the proxy group.

34. Finally, the Commission notes that the capital structure in Bay Gas's filing, dated December 31, 2003, is more than a year old. The dividend yields and expected five-year growth rates for Bay Gas's two-step DCF analysis are also stale in that the dividends cover the six months ended January 2004, while the growth rates are from a publication dated December 3, 2003. Moreover, the calculation of the growth rate, or *g* factor, in Bay Gas's DCF equation does not include an estimate of the long-term growth rate for the U.S. economy, as measured by the Gross Domestic Product, and as required by the Commission in gas pipeline proceedings.[25]

Rate Design

35. Bay Gas's proposed transportation rates are designed by dividing its cost of service by the billing determinants. We find this approach acceptable. However, due to the rate of return adjustment, the revised total cost of service for the system as a whole is $5,687,279,[26] which is $771,099 less than Bay Gas's filed estimate. The billing units for the original and the Whistler spur facilities, the discount adjustment, and the allocation to storage service have been adequately supported, and no competitor or customer has objected to the proposed rate design. Accordingly, we will use a transportation billing determinant that Bay Gas proposes in its October 14, 2004 data responses to the Staff Panel's September 21, 2004 requests in this proceeding. The computed maximum fair and equitable rolled-in rate for Bay Gas's section 311 transportation service is $1.3132

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[24] 84 FERC ¶ 61,084 (1998).

[25] *See Northwest Pipeline Co.*, Opinion No. 396-B, 79 FERC ¶ 61,309, at 62,383 (1997).

[26] For the cost of service calculation, see the appendix to this order.

per MMBtu for firm transportation-only service, and $0.0432 per MMBtu for interruptible transportation-only service.

The Commission orders:

(A) Bay Gas's proposal to roll in costs of the Whistler spur facilities is accepted. The Commission approves, as fair and equitable, a rate of $1.3132 per MMBtu for firm transportation service under NGPA section 311 and a rate of $0.0432 per MMBtu for interruptible transportation-only service.

(B) Bay Gas's compliance filing, removing section 17 F from its General Terms and Conditions, is hereby accepted.

(C) Bay Gas must file on or before March 9, 2007, a new application for rate approval pursuant to section 284.123(b)(2) of the Comission's regulations to justify its existing rates or establish a new maximum rate.

By the Commission. Commissioner Brownell dissenting in part with a separate statement attached.

Linda Mitry,
Deputy Secretary.

APPENDIX

BAY GAS STORAGE COMPANY
COST OF SERVICE
PR04-9-000 & 001

Cost of Service Accts.	Original Facilities	Whistler Spur
Operating & Maintenance	$922,110	$136,441
Depreciation	529,846	379,936
Other Taxes	166,811	114,805
Fed. Income Tax	388,092	343,907
State Inc. Tax	79,352	70,318
Return on Debt	604,245	537,248
Return on Equity	748,584	665,584
Total Cost of Service	$3,439,040	$2,248,239

Cost of Service Debits		
Allocation to Storage Trans.	$ 829,698	0
Discount Adj. Revenue Credit	1,460,000	0
Total Debits	$2,289,698	0
Rate Design Cost of Service	$1,149,342	$2,248,239
Billing Units (MMBtu)	718,800	1,868,400

Calculated Incremental Rates	Original Facilities	Whistler Spur
Firm Transportation Service	$1.5990	$1.2033
Interruptible Trans. Service	$0.0526	$0.0396

Calculated Roll-In Rates	
Firm Transportation Service	$1.3132
Interruptible Trans. Service	$0.0432

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Bay Gas Storage Company

Docket Nos. PR04-9-000 and PR04-9-001

(Issued June 2, 2005)

BROWNELL, Commissioner, dissenting in part:

I would not impose a triennial rate approval requirement on section 311 pipelines, for the reasons set forth in Green Canyon Pipe Line Company, L.P., 98 FERC ¶ 61,041 (2002).

I believe that the record developed in this proceeding is insufficient to support the majority's decision on the appropriate rate of return on equity for the reasons set forth in High Island Offshore System, L.L.C., 110 FERC ¶ 61,043 (2005).

Nora Mead Brownell
Commissioner