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SourceGas

March 4, 2008

ADVICE LETTER NO. 228

Doug Dean, Director
Colorado Public Utilities Commission
1560 Broadway, Suite 250
Denver, CO 80202

Dear Mr. Dean:

SourceGas Distribution LLC ("SourceGas Distribution") herewith submits the following Tariff Sheets for filing with the Commission in compliance with requirements of the Colorado Public Utilities Law:

Colorado PUC Tariff No. 7

Page No.	Revision No.	Cancels Page No.	Revision No.
1	First	1	Original
2	First	2	Original
2A	First	2A	Original
2B	First	2B	Original
3A	First	3A	Original
4	First	4	Original
5	First	5	Original
5A	Original	--	--
5B	Original	--	--
5C	Original	--	--
5D	Original	--	--
6	First	6	Original
7	First	7	Original
7A	Original	--	--
7B	Original	--	--
7C	Original	--	--
7D	Original	--	--
7E	Original	--	--
7F	Original	--	--
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7H	Original	--	--

7I	Original	--	--
7J	Original	--	--
8	First	8	Original
9	First	9	Original
10	First	10	Original
11	First	11	Original
12	First	12	Original
13-28	First	13-28	Original
30-36L	First	30-36L	Original
37	First	37	Original
38	First	38	Original
38A	First	38A	Original
38B	First	38B	Original
39	First	39	Original
39A-39C	First	39A-39C	Original
39D	First	39D	Original
39E	First	39E	Original
39F	Original	--	--
39G	Original	--	--
39H	Original	--	--
39I	Original	--	--
39J	Original	--	--
40	First	40	Original
40A	First	40A	Original
44	First	44	Original
47	First	47	Original
63	First	63	Original
66	First	66	Original
70	First	70	Original
71	First	71	Original
72	First	72	Original
73	First	73	Original
74	First	74	Original
75	First	75	Original
76	First	76	Original
76A	First	76A	Original
77	First	77	Original
77A	First	77A	Original
78	First	78	Original
79	First	79	Original
80	First	80	Original
81	First	81	Original
81A	First	81A	Original
81B	First	81B	Original
81C	First	81C	Original
82	First	82	Original

85	First	85	Original
88	First	88	Original
88A	First	88A	Original
93B	First	93B	Original
98	First	98	Original
102	First	102	Original
103	First	103	Original
104A	First	104A	Original
104B	First	104B	Original
104E	First	104E	Original
105	First	105	Original
106	First	106	Original
107	First	107	Original
108	First	108	Original
109	First	109	Original
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127	First	127	Original
135	First	135	Original

As further detailed in the Statement of Nature, Reasons, and Basis, attached to this Advice Letter as Appendix A, the purpose of this filing is to increase the non-gas base rates and charges for the service that SourceGas Distribution renders in its five Colorado service areas: Arkansas Valley, North Central, North Eastern, Southwestern, and Western Slope. The non-gas base rates and charges applicable to service in each of these areas have not been subject to adjustment in 14-18 years, depending on the area. By this filing, SourceGas Distribution also proposes to implement certain initiatives that will allow SourceGas Distribution to streamline its service and recover its cost of service and earn a reasonable rate of return. In particular, SourceGas Distribution seeks to consolidate its current five rate areas within Colorado into a single rate area for non-gas base rates, to calculate bills on a thermal basis, to combine the assets owned and operated by SourceGas Wattenberg LLC into SourceGas Distribution's cost of service, to update its schedule of special charges, to update the method of calculating and the amount of main and service line construction allowances, and to implement bad debt and pipeline integrity cost adjustment mechanisms.

The effect of this filing on SourceGas Distribution's annual non-gas base rate revenues would be an increase of $17,741,141. The test year underlying this filing is the twelve months ended August 31, 2007. The proposed adjusted test year adjusts test year data to reflect known and measurable changes occurring subsequent to the end of the test year. The proposed increase in non-gas base rates and charges would allow SourceGas Distribution the opportunity to earn a 10.75% return on equity and a 8.53% overall return on rate base. As reflected in Exhibit 3, Schedule 2, accompanying this filing, SourceGas Distribution currently is earning an overall return on rate base, on a pro forma basis, of -0.56%.

The proposed effective date of this filing is April 4, 2008.

Enclosed are the original plus ten (10) copies of the Advice Letter and the original and three (3) copies of the accompanying Tariff Sheets and supporting direct testimony and exhibits.

SourceGas Distribution will give notice of the proposed modifications to its Tariff in the Form of Notice attached to this Advice Letter as Exhibit 1.

Please contact the following persons if you have any questions regarding this filing:

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Sincerely,

Bentley W. Breland

Bentley W. Breland
CFO and Sr. Vice President, Regulatory

BWB:cpb
Attachments
cc: hand delivered to:

Office of Consumer Counsel
Attn: James Greenwood
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Denver, CO 80202

APPENDIXES

A. Statement of Nature, Reasons, and Basis

EXHIBITS

1. Form of Notice
2. Proposed Tariff Sheets
3. Schedules 1-33

DIRECT TESTIMONIES

Testimony and Exhibits of Mr. Daniel E. Watson

Testimony and Exhibits of Mr. Bentley W. Breland

Testimony and Exhibits of Mr. Douglas D. Whitefoot

Testimony and Exhibits of Mr. William H. Meckling

Testimony and Exhibits of Mr. James M. Elliott

Testimony and Exhibits of Mr. Jerrad S. Hammer

Testimony and Exhibits of Mr. Gary J. Abbate

Testimony and Exhibits of Mr. R. Charles Moyer, Ph.D.

Testimony and Exhibits of Mr. Thomas J. Sullivan

Testimony and Exhibits of Mr. Larry W. Loos

Testimony of Mr. Alan R. Lovinger

APPENDIX A

STATEMENT OF NATURE, REASONS, AND BASIS

SourceGas Distribution LLC ("SourceGas Distribution") provides retail natural gas distribution service to the five service areas in Colorado formerly served by Kinder Morgan, Inc. ("Kinder Morgan"). These service areas are identified in SourceGas Distribution's Tariff as the Arkansas Valley, North Eastern, North Central, Southwestern, and Western Slope divisions. SourceGas Distribution has not filed a general rate increase in Colorado since it began operations on or about March 31, 2007. Indeed, the most recent general rate increases for these service areas occurred between 1990 and 1994. In the 14-18 years since the last rate increases in the SourceGas Distribution service areas, the associated cost of service has changed substantially. Accordingly, pursuant to the Colorado Public Utilities Law, Colo. Rev. Stats. §§ 40-3-101 *et seq.* (the "Act"), SourceGas Distribution hereby is seeking to change its rates for natural gas service for its sales and distribution transportation service customers in Colorado, and to implement the initiatives set forth in the Tariff Sheets accompanying Advice Letter No. 228.

I. BACKGROUND

SourceGas Distribution is a "public utility" as defined in Section 40-1-103 of the Act. SourceGas Distribution provides retail natural gas sales and distribution transportation service to approximately 85,000 customers in Colorado. SourceGas Distribution also provides retail natural gas service to customers in the states of Nebraska and Wyoming. SourceGas Distribution's net investment in its Colorado retail properties totals approximately $122,277,027 and its retail unit employs approximately 262 persons in Colorado.

Until last year, Kinder Morgan provided natural gas service to customers in the five Colorado service areas now served by SourceGas Distribution. SourceGas Distribution began delivering natural gas service to these service areas on or about March 31, 2007, after the Commission approved Kinder Morgan's sale and transfer of ownership of SourceGas Distribution. *See* Colo. P.U.C. Decision No. C07-0247, Docket No. 06A-533G.

SourceGas Distribution adopted Kinder Morgan's Tariffs on June 29, 2007. *See* Submission in Compliance with Order, Docket No. 06A-533G (June 29, 2007). Thereafter, by Advice Letter No. 226, SourceGas Distribution consolidated the Tariffs governing its Colorado rate areas into a single Tariff, Colorado P.U.C. Tariff Vol. No. 6, effective February 8, 2008, and cancelled P.U.C. Tariff Vol. No. 11, which had been applicable to the Arkansas Valley and Southwestern service areas. By SourceGas Distribution's application in Docket No. 08L-065G, which the Commission approved in its Decision No. C08-0200, SourceGas Distribution restated this Tariff as its P.U.C. Tariff Vol. No. 7 in order to update the name on the Tariff to its own.

At present, the rates set forth in P.U.C. Tariff Vol. No. 7 have not been adjusted in 14 to 18 years. Specifically, the five service areas last had non-gas base rate increases as follows:

- Arkansas Valley – effective November 28, 1990
- North Central Colorado – effective September 1, 1994
- North Eastern Colorado – effective August 1, 1992
- Southwestern – effective November 28, 1990
- Western Slope – effective September 1, 1994

Over the past 14-18 years, SourceGas Distribution and the former owners of these assets have managed to control costs while investing in improvements to maintain the safety and reliability of their Colorado system. The cost of service has steadily increased over this many-year period.

As shown by the revenue requirement study accompanying this filing, SourceGas Distribution's current rates do not allow it to recover its costs and earn a reasonable rate of return. In fact, SourceGas Distribution is currently earning a return of *negative 0.56%* on its investment in Colorado, as shown by the revenue requirement study. SourceGas Distribution is therefore proposing to increase its rates by approximately $17.7 million per year for its sales and distribution transportation customers in Colorado, which would provide SourceGas Distribution the opportunity to recover its cost of service and earn a fair and reasonable return of 8.53% on its investment.

SourceGas Distribution has designed its proposed rates and other initiatives to accomplish the following: (1) consistency and simplicity; (2) a fair apportionment of costs among customers; (3) more levelized payments for customers over any given annual period; (4) reflect SourceGas Distribution's current cost structure and business conditions; and (5) increased stability in SourceGas Distribution's rate structure.

II. INITIATIVES SOUGHT IN TARIFF REVISION

1. General Rate Increase.

The last rate increases in SourceGas Distribution's Colorado service areas occurred between 1990 and 1994. Thus, the data and assumptions regarding the utility's cost structure and business conditions have become outdated. In order to continue to meet the service requirements of its Colorado customers, SourceGas Distribution is proposing to increase its Colorado rates, effective April 4, 2008, to increase its revenues by $17.7 million per year.

As explained in the testimony of Mr. Bentley W. Breland, SourceGas Distribution has determined the cost to provide natural gas service to customers within all SourceGas Distribution Colorado service areas for the twelve months ended August 31, 2007 (the "Test Year").

SourceGas Distribution compiled data using generally accepted practices to formulate its Adjusted Test Year, which reflects known and measurable changes occurring subsequent to the Test Year. SourceGas Distribution's Adjusted Test Year results show that SourceGas Distribution is currently earning a pro forma negative overall rate of return on rate base: -0.56%. This is far below the fair and reasonable return required under the Act and applicable case law.

SourceGas Distribution has prepared a cost of service and revenue requirement study and prepared schedules based upon actual costs, investments, and revenues, as of the end of the Test Year, adjusted for known and measurable changes. If the Commission accepts SourceGas Distribution's filing, SourceGas Distribution will earn a projected overall return on its rate base of 8.53% and a return on common equity of 10.75%.

The proposed rate increase and the reasons for it are described further in the direct testimony that SourceGas Distribution has submitted as part of its filing.

2. Consolidation of Rate Areas and Implementation of Thermal Billing.

SourceGas Distribution seeks to consolidate the current five Colorado rate areas into a single rate area, so that customers within each class statewide are charged the same non-gas base rate.[1] SourceGas Distribution incurs similar costs to serve its customers in all of the five service areas, and establishing uniform rates throughout SourceGas Distribution's Colorado service territory will increase administrative efficiency. To provide for a uniform rate, by class, SourceGas Distribution is seeking approval to convert its billing basis to thermal billing. Given

[1] Pursuant to Commission Decision No. C05-0592, adopted on April 15, 2005 in Docket No. 04A-113G, Kinder Morgan used the existing rates for its Whitewater expansion and agreed to hold the ratepayers harmless from any loss associated with the construction and initial provision of service to customers in the Whitewater Service Territory until the Whitewater project breaks even. Consistent with that decision, in this rate case, SourceGas Distribution determined that the rates that would be charged to customers attached in the Whitewater expansion, calculated on Whitewater costs, would be substantially higher than the rates, by class, that SourceGas proposes to charge to its other Colorado customers. Therefore, SourceGas Distribution has determined to charge the Whitewater expansion customers the same rates, by class, that it proposes to charge its other Colorado customers. SourceGas has not reflected the resulting temporary revenue deficiency in the rates proposed by this filing.

the differences in gas costs among some of the five Colorado service areas, SourceGas Distribution is not proposing to consolidate gas cost adjustment ("GCA") charges.

The proposed initiative to consolidate SourceGas Distribution's five Colorado rate areas is described in the direct testimony of Mr. Meckling. The conversion to thermal billing is described in the testimony of Messrs. Douglas D. Whitefoot, Thomas J. Sullivan, and Gary J. Abbate.

3. Pipeline Integrity Cost Adjustment.

As a result of the Department of Transportation's ("DOT") pending expansion of pipeline safety integrity management requirements to local distribution companies, SourceGas Distribution proposes to implement a Pipeline Integrity Cost Adjustment ("PICA") rate mechanism to recover, *inter alia*, incremental costs incurred in complying with new rules. The DOT's Distribution Integrity Management Rule is scheduled to be published on June 7, 2008. *See* DOT Rulemaking Schedule at http://regs.dot.gov/rulemakings/200802/phmsa.htm?type=html#73.

The Distribution Integrity Management Rule will require local distribution companies such as SourceGas Distribution to implement protocols to assess safety risks within their systems. SourceGas Distribution will be required to identify, assess, and rank risks along its system and make additions, modifications, and replacements as required to eliminate or improve those risks. SourceGas Distribution will be required to locate and address anomalies, including replacing pipeline. Finally, SourceGas Distribution will be required to conduct training, enhance damage prevention programs, and meet periodic reporting requirements.

Compliance with the Distribution Integrity Management Rule will result in significant new pipeline safety integrity management program costs. To appropriately account for these new costs once the Rule has been implemented, the proposed PICA will track both capital expenditures and operation and maintenance expenses associated with compliance with pipeline integrity rules. This proposed initiative is described further in the direct testimony of Messrs. Breland, Whitefoot, and Elliott.

4. Bad Debt Cost Adjustment.

SourceGas Distribution proposes to add a cost adjustment mechanism to its Tariff that will recognize fluctuations in bad debt costs attributable to customers' nonpayment of bills. The proposed bad debt cost adjustment mechanism is described in the testimony of Mr. Hammer.

5. Update Construction Allowances and Methodology.

SourceGas Distribution is proposing to increase its Regular Construction Allowance from \$300 to \$995 (plus \$2.75 per therm of expected usage over 723 therms) to defray new residential customers' costs of establishing service where this requires connection to a new service line or a main extension. The Regular Construction Allowance is that portion of the upfront cost of connecting a new customer that SourceGas Distribution bears.

SourceGas Distribution also proposes to offer customers an Extra Construction Allowance to defray the initial cost to households to connect to SourceGas Distribution's system. In addition to the \$995 regular Construction Allowance, SourceGas Distribution proposes this Extra Construction Allowance of up to \$2,975, which it will then recoup over time through a \$40 monthly charge in the customer's bill.

The proposed increase to SourceGas Distribution's Regular Construction Allowance and the proposed Extra Construction Allowance are described in the direct testimony of Messrs. Watson and Hammer.

6. SourceGas Wattenberg LLC.

SourceGas Wattenberg LLC ("SourceGas Wattenberg") owns and operates natural gas facilities used to provide service to two transportation customers situated near the City of Fort Morgan, Colorado. SourceGas Wattenberg was organized to be a "Natural Gas Company" subject to the jurisdiction of the Federal Energy Regulatory Commission, and originally filed its tariff at the FERC. In *City of Fort Morgan v. Colo. Public Utils. Comm'n*, 159 P.3d 87 (Colo. 2007), it was established that SourceGas Wattenberg's services are within this Commission's jurisdiction. As a result of that decision, SourceGas Wattenberg and SourceGas Distribution have determined that they will seek the Commission's approval to combine SourceGas Wattenberg and SourceGas Distribution. This will allow for administrative and regulatory efficiencies since services can then be provided under one Tariff. This will produce a modest decrease in SourceGas Distribution's need for increased revenues. Accordingly, SourceGas Distribution's filing reflects the costs and revenues associated with the service currently provided by SourceGas Wattenberg.

This proposed initiative is described further in the testimony of Messrs. Watson and Elliott.

7. Update Schedule of Special Charges.

SourceGas Distribution is proposing to update its Special Charges to increase its standard hourly service charge, from $33 to $55 to reflect the actual cost. SourceGas Distribution proposes to modify the Continuing Service Charge to recover the Customer Charge component of its billing from customers who have temporarily disconnected service. SourceGas Distribution also proposes to increase the amounts of the Reconnection Charge, Bill Collection Charge, and Meter Test Charge.

These proposed changes to SourceGas Distribution's Special Charges are described in the direct testimony of Mr. Elliott.

III. IMPLEMENTATION OF TARIFF CHANGES

SourceGas Distribution's rates contain both a Customer Charge and a Volumetric Charge component. SourceGas Distribution proposes to recover a larger proportion of the fixed costs of its system through the Customer Charge component of its rates. Recovery of greater fixed costs in monthly Customer Charge adds greater stability to customer bills.

IV. WITNESSES

SourceGas Distribution's direct case consists of the proposed Tariff Sheets, the supporting exhibits, and the direct testimony and associated exhibits of its witnesses, which are included with Advice Letter No. 228. The direct testimony of Mr. Daniel E. Watson, CEO and President of SourceGas Distribution, presents a summary of the subjects addressed by the other witnesses.

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