TRANSWESTERN PIPELINE COMPANY, LLC

Statement of the Nature, Reasons and Basis for the Filing
Including Summary of Changes or Additions to Tariff
and Explanation of Need for Changes

Transwestern Pipeline Company, LLC ("Transwestern") has included herein the following tariff changes to Third Revised Volume No. 1 of its FERC Gas Tariff:

(1) The tariff sheets identified in Appendix A reflect a general rate increase applicable to Transwestern's transportation services, including modification to its fuel reimbursement percentages; and,

(2) The tariff sheets identified in Appendix B, which do not constitute a change in rates, contain certain proposed changes to the Rate Schedules, the General Terms and Conditions, and the Forms of Service Agreements. The changes contained in Appendix B:

- Eliminate Rate Schedules FTS-3 and EFBH and associated Forms of Service Agreements;
- Incorporate certain language to provide for reservation charge credits under certain specific conditions;
- Revise the creditworthiness provisions;
- Incorporate certain language to simplify the scheduling of alternate receipt and/or delivery points;
- Modify certain language to update and clarify the operational procedures and Alert Day provisions;
- Propose certain gas quality specifications contained in Section 2 of its General Terms and Conditions; and,
- Modify the procedures for awarding unsubscribed capacity.

A. Nature of the Filing

The changes in rate levels in this filing are designed based on the filed billing determinants and throughput levels for transportation services. The principal factors supporting the increase in cost of service are:

(a) an increase in rate base resulting from additional plant; and

(b) an increase in rate of return and related taxes.

The primary reason for the filing of the Revised Tariff Sheets is to adjust Transwestern's rates for transportation services. The computed cost of service herein, when compared with the cost of service underlying Transwestern's currently effective rates, indicates an annual increase of approximately $41.1 million; however, projected transportation revenues total $181.8 million, an annual increase of $3.2 million.

In compliance with Section 154.7(a)(6) of the Commission's regulations, 18 CFR §154.7(a)(6), the following table compares the cost of service, rate base and throughput underlying this filing with the same information underlying the last rate found just and reasonable by the Commission:

	Instant Filing	RP93-34[1]
Transport Revenues	$181,823,781	$169,800,000
Cost of Service	$210,780,870	$169,800,000
Rate Base	$792,174,014	$465,000,000
Throughput (MMBtu/d)		
West of Thoreau	700,000	717,000
East of Thoreau	810,000	566,000
San Juan	1,235,000	350,000

Transwestern's overall cost-of-service, as detailed in Statement A, for the Base Period ending May 31, 2006, adjusted for known and measurable changes through February 28, 2007, justify the rate increase. Transwestern is prudently controlling expenses, and taking a conservative approach in its rate proposals to better meet the demands of the marketplace, while striving to match cost incurrence with cost causation.

1. Unchanged Rate Components

A number of components of Transwestern's proposed rates represent a continuation of existing practices. Transwestern generally has retained the methods of cost classification and rate design that underlie its currently effective rates. As more fully explained in Transwestern's testimony:

a. **Straight-fixed Variable Method.** Transwestern continues to design rates using the Commission-preferred straight fixed variable ("SFV") method.

b. **Matrix of Rates.** Transwestern continues to employ a matrix of rates depending on the combination of receipt and delivery areas using the current designations of Transwestern's system.

c. **Discount adjustment.** Transwestern calculates it's billing determinants by making a discount adjustment which utilizes the iterative methodology preferred by the Commission. Such adjustment is made in accordance with the goals and directives of the Commission's Rate Design Policy Statement[2] that allows a pipeline to seek a reduction in the volumes used to design its maximum rates, if it obtained those volumes by offering discounts to meet competition.

d. **IT Rate Design.** Transwestern has continued the design of its interruptible transportation rate for service under Rate Schedule ITS-1 on a 100% load factor equivalent of the basic FTS-1 firm transportation rate. Transwestern recognizes the

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1 Pursuant to Settlements approved by the Commission in Docket No. RP94-227-000, et al., and Docket No. RP95-271-000, et al., certain parts of the Docket No. RP93-34-000 Settlement were modified, without identifying any underlying cost of service component adjustment.

2 *Policy for Selective Discounting by Natural Gas Pipelines*, 111 FERC ¶ 61,309 (2005).

Commission's preference for a 100 percent load factor interruptible rate, and believes that circumstances continue to exist to warrant such design.

2. **Proposed Changes**

Transwestern's proposed revised tariff sheets also change several aspects or underlying elements of Transwestern's currently effective tariff. Transwestern bases these changes on the statements and schedules enclosed with this filing pursuant to Section 154.312 of the Commission's regulations, including the prepared testimony of Transwestern's witnesses. As more fully explained therein, Transwestern's proposed changes include the following:

a. Cost of capital. The proposed rates incorporate an overall cost of capital of 10.30 percent, based on Transwestern's actual, stand-alone, Test Period capitalization. This cost of capital reflects the decision by Transwestern to file for an equity return commensurate with Transwestern's risks in the highly competitive market environment in which it operates. Thus, Transwestern's filed cost of capital is as follows:

Capital Component	Weight	Cost	Wgtd. Cost
Long-Term Debt	41.45%	5.80%	2.40%
Cost of Common Equity Requested by Transwestern	58.55%	13.50%	7.90%
Overall Cost of Capital Requested by Transwestern			10.30%

b. Depreciation Rate. Transwestern has filed for a transmission depreciation rate of 1.20% for its San Juan Expansion facilities, which is lower than the 2.86% transmission depreciation rate that was included in Transwestern's certificate filing in Docket No. CP04-104-000. By lowering this depreciation rate, on facilities which Transwestern proposes to roll-in as described below, all of Transwestern's transmission facilities will be depreciated at the same 1.20% rate.

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Transwestern adopted the new rules on asset retirement obligations ("ARO") on January 1, 2003. In March 2005, the FASB issued FASB Interpretation ("FIN") No. 47, "Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143," which clarified the rules related to ARO accounting. Transwestern adopted FIN No. 47 in December 2005.

Section 154.315 of the Commission's regulations, 18 CFR §154.315, addresses a natural gas company's rate case filing requirements related to AROs. Under those requirements, a company may seek to recover non-rate base costs related to AROs, but all ARO cost components that would impact the calculation of rate base must be removed from the rate base calculation. In the instant filing, Transwestern has complied with Section 154.315 of the Commission's regulations, and has reflected ARO depreciation expenses of $25,684 and accretion expenses of $58,380 for its transmission facilities.

c. Capital Expansions. Transwestern proposes to roll into its system-wide rates the costs of the following expansions:

i. **San Juan 2005 Expansion:** Transwestern's 375 MMcf/day, San Juan Lateral Expansion Project (Docket No. CP04-104-000, et al.). [108 FERC ¶ 61,157 (2004)].

ii. **San Juan – Phase I and II Expansions:** Transwestern's 255 MMcf/day, San Juan Lateral Expansion Projects (Docket Nos. CP96-10-000 and CP97-516-000). [75 FERC ¶ 61,107 (1996) and 81 FERC ¶ 61,217 (1997), respectively].

iii. **Gallup Expansion:** Transwestern's 50 MMcf/day, San Juan Lateral Expansion Project (Docket No. CP99-522-000). [90 FERC ¶ 61,032 (2000)]. In addition to increasing the capacity of the San Juan Lateral, the new compression at the Gallup, New Mexico compressor station restored 140,000 Dth/day of capacity on Transwestern's West of Thoreau mainline facilities.

iv. **Red Rock Expansion:** Transwestern's 120 MMcf/day, Mainline Expansion Project (Docket No. CP01-115-000). [96 FERC ¶ 61,078 (2001)].

d. Fuel. Transwestern is proposing to restate its fuel reimbursement percentages to reflect the fuel use and loss and unaccounted for gas that it estimates will be needed as a result of the changed conditions on, and utilization of, its system since Transwestern's last general rate filing.

e. Tariff Revisions. In addition to the modifications discussed above, Transwestern proposes to make certain changes to its tariff, and to implement those changes in conjunction with the rate modifications filed herein. The basis for these changes can be found in the testimony of Mr. Michael Langston. Those proposed tariff changes include:

i. elimination of Rate Schedules FTS-3 and EFBH, as well as the Forms of Service Agreements associated with these two Rate Schedules. No contracts for these services have ever been executed by Transwestern ;

ii. incorporating certain language to allow for reservation charge credits in Rate Schedules FTS-1 and FTS-2, under specific conditions consistent with the commitment made by Transwestern in Docket No. RP04-214;

iii. incorporating certain quality standards into Section 2 of its General Terms and Conditions, (1) to include a maximum allowable heat content for gas received into Transwestern's system, (2) to establish a stated hydrocarbon dew point (HDP) as a safe harbor for gas received into Transwestern's system, (3) to establish a WOBBE Index for gas interchangeability, (4) to reduce the allowed oxygen content of gas received into Transwestern's system, (5) to incorporate the Commission's Policy Statement on Gas Quality regarding delivery standards, and (6) to eliminate the specific gas quality specifications for the La Plata facilities;

iv. modifying the creditworthiness provisions;

v. incorporating certain language to simplify the scheduling of alternate receipt and/or delivery points;

vi. modifying Section 22.4 of the General Terms and Conditions to provide for a reduction in the minimum notice for an Alert Day from 24 hours to 2 hours and modifying the penalty for non-compliance; and,

vii. modifying the procedures for awarding unsubscribed capacity on Transwestern's system.

B. Reasons for the Filing

Transwestern is submitting this rate filing to comply with the Stipulation and Agreement dated May 21, 1996 in Docket Nos. RP95-271-000, et al., and approved by Commission Letter Order dated October 16, 1996. The revised rates reflect: (1) increases in rate base; (2) increases in overall rate of return and related taxes; and (3) rolled-in rate treatment for certain gas plant additions. In this filing, Transwestern also seeks to make other revisions to its tariff as more fully described above.

1. Increased Rate Base

The revised tariff sheets reflect a rate base of $792.2 million. This is an increase of $327.2 million, or 70.4%, over the rate base underlying the 1993 Settlement rates. Transwestern's rate base has increased as a result of several major capital additions in recent years, including the San Juan Phase I and II Expansions, the Gallup Expansion, and the Red Rock Expansion. Transwestern's increased rate base also reflects the addition of the San Juan 2005 Expansion Project, which the Commission certificated in Docket No. CP04-104-000, and which commenced service on May 1, 2005.

2. Increased Rate of Return

The revised tariff sheets reflect an overall rate of return on rate base of 10.30. Transwestern utilizes its actual capital structure for the purposes of calculating Transwestern's rate of return allowance. Using Transwestern's capital structure (consisting of 58.55% equity and 41.45% debt) is appropriate because Transwestern issues its own non-guaranteed debt, has a bond rating separate from its parent, and has an equity ratio that is within the range of equity ratios recently approved by the Commission. Transwestern has based its return allowance on its weighted average cost of debt, which is 5.80%. Transwestern is requesting a return on equity of 13.50%, which reflects Transwestern's risks which justify the requested return on equity. The overall rate of return requested by Transwestern is demonstrably reasonable and, indeed, conservative.

3. Billing Determinants

The billing determinants used in this filing reflect actual volumes for the twelve months ended May 31, 2006, as adjusted for known and measurable changes in contract demand and usage throughput, through the end of the Test Period ending February 28, 2007. Contracts which began during the Base Period or Test Period, and will continue beyond the Test Period, have been annualized. Likewise, contracts which expired and were not renewed during the Base Period, or are known to expire during the Test Period, have been eliminated for purposes of calculating the billing determinants.

C. Basis for the Filing

The basis for Transwestern's proposed changes are fully detailed in Statements A through J, L, M and O, submitted as part of this rate filing, and as described in Section 154.312 of the Commission's regulations [18 CFR §154.312]. In addition, Statement P, submitted herewith, contains prepared direct testimony setting forth the evidence that supports Transwestern's case-in-chief. The testimony of Transwestern's witnesses supports the following components of Transwestern's rates:

Witness	Testimony
Michael T. Langston	Background Information Related to Filing, Capital Structure, Including Selection of Equity Return, Fuel Retention Percentages, Base Rates and Tariff Revisions
Lawrence J. Biediger	Overall Cost of Service, Rate Base, Accumulated Deferred Income Taxes, Operating Costs, Depreciation Expense, and Income Taxes
Rickey J. Brocato	Gas Plant, Accumulated Provision for Depreciation, Working Capital and Other Taxes
Shelley A. Corman	Commercial and Market Issues, Customer Volumes, Test Period Adjustments for Reservation Billing Determinants and Commodity Billing Determinants, and Discounting Requirements
William W. Grygar	Classification, Cost Allocations and Rate Design for Transportation Services, and Justification for Roll-in of Expansion Project Facilities
Blair V. Lichtenwalter	Revenues, Revenue Credits and Gas Balance
Stephen D. McGregor	Effective Income Tax Rates
Robert B. Hevert	Range of Return on Equity
John J. Reed	Business Risks