Docket No, UG-06____
Exhibit ____(MDM-1T)
Witness: Matthew D. McArthur

BEFORE THE

WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

UG-06_____

GENERAL RATE APPLICATION

OF

CASCADE NATURAL GAS CORPORATION

We make warm neighbors

www.cngc.com

February 14, 2006

Prepared Direct Testimony of
Matthew D. McArthur

(Proforma Cost of Capital)
(Cost of Long-Term Debt)
(Proforma Capital Structure)
(Short Term Borrowing Balance for January 2006)

Prepared Testimony of Matthew D. McArthur

(Cost of Capital)

Q. Please state your name and address for the record.

A. Matthew McArthur, 222 Fairview Avenue North, Seattle, Washington.

Q. By whom are you employed and what is your title?

A. I am employed by Cascade Natural Gas Corporation ("Cascade" or the "Company") as Treasurer.

Q. Please describe your education and employment background.

A. I graduated from Brigham Young University in 1990 with a Bachelor of Arts degree in Economics and from Texas A&M University in 1992 with a Master of Business Administration. I then worked for Price Waterhouse for the next five years. While at Price Waterhouse, I received a CPA certification. I then spent the next four years at two software development companies, Wall Data and Quintessent, as the Financial Reporting Manager and Controller, respectively. I then joined Philips Medical Systems as the Divisional Controller for the MR/CT division where I spent two years. In April 2004, I joined Cascade as the Senior Director of Finance and was promoted to Treasurer in September 2005.

Q. Have you previously sponsored testimony before utility commissions?

A. No.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony in this proceeding is to recommend the appropriate Cost of Capital for Cascade. For the cost of equity, I used Dr. Morin's recommended return on equity (ROE) of 11.15%. For the cost of debt, my testimony describes how I calculated the cost of long-term debt based on the Company's currently outstanding debt issuances. To arrive at the Cost of Capital, I used Dr. Morin's recommended capital structure of 50% common equity capital and 50% debt capital. As additional support for Dr. Morin's recommended capital structure, I will provide forward-looking information that shows that the Company's capital structure is expected to achieve the recommended 50% equity ratio. I will also discuss the Company's use of short-term debt, which is a financing source for working capital needs and not for financing long-term invested capital.

Q. Do you sponsor exhibits as part of this filing?

A. Yes. I sponsor four exhibits. These exhibits are marked as follows: Exhibit __ (MDM-2), Proforma Cost of Capital; Exhibit __ (MDM-3), Cost of Long-Term Debt; Exhibit __ (MDM-4) Proforma Capital Structure; and Exhibit __ (MDM-5) Short Term Borrowing Balances for January 2006.

Q. Were these exhibits prepared by you or under your supervision?

A. Yes they were.

Q. Please begin by explaining Exhibit __ (MDM-2).

A. Exhibit __ (MDM-2) provides the Company's recommended capital structure and cost of capital. The recommended capital structure is 50% common equity capital and 50% debt capital, as discussed in Dr. Morin's testimony. Exhibit __ (MDM-2) also reflects Dr.

CASCADE NATURAL GAS CORPORATION
222 FAIRVIEW AVENUE NORTH
SEATTLE, WA 98109
(206) 624-3900

Morin's recommended return on common equity of 11.15%. The remaining element in the cost of capital computation, the cost of long-term debt, is 7.58%. This produces an overall rate of return of 9.37%, as shown Exhibit __ (MDM-2).

Q. Please explain the cost rate for long-term debt on line 1 of Exhibit __ (MDM-2).

A. Long-term debt details are presented on Exhibit __ (MDM-3), Cost of Long-Term Debt. This Exhibit identifies the specific long-term debt issues, which total $173,840,000 at September 30, 2005 and their effective rates.

Q. On Exhibit __ (MDM-3), please explain the long-term debt effective rates in column (d).

A. The effective rates in Exhibit __ (MDM-3) are calculated by taking the stream of cash flows related to the debt issuance and calculating the internal rate of return (IRR). The net proceeds or cash inflow of the debt issuance is obtained from the debt proceeds less any costs of issuing the debt. These costs may include agent fees, legal costs, premiums to redeem original debt, rating agency fees and other costs. Cash outflows are semi-annual or quarterly interest payments and the original principal amount at the end of the term.

Q. Please explain the purpose of Exhibit __ (MDM-4).

A. The purpose of Exhibit __ (MDM-4) is to support the capital structure recommended by Dr. Morin. Exhibit __ (MDM-4) demonstrates that Cascade's proforma capital structure will approximate 50% common equity capital and 50% debt capital at the end of fiscal year 2007. The proforma long-term debt is calculated by taking the September 30, 2005 balance less the deferred gas costs balances at September 30, 2005 and less projected cash flows for fiscal years 2006 and 2007. A portion of the $45 million in long-term debt sold in fiscal 2005 was used to finance Cascade's deferred gas cost balances. Cascade anticipates that the

CASCADE NATURAL GAS CORPORATION
222 FAIRVIEW AVENUE NORTH
SEATTLE, WA 98109
(206) 624-3900

deferred gas costs should be reduced to zero over the next two fiscal years, which would generate cash to pay down long-term debt. The deferred gas cost balance of $16.2 million at September 30, 2005 is benefited by a positive balance with customers in the state of Oregon. Projected cash flows for fiscal years 2006 and 2007 were based on projected Net Income, adding back Depreciation and proceeds from shares issued (primarily from the Company's Dividend Reinvestment Program), and subtracting Dividends and Capital Expenditures in each year. Other changes to cash are primarily related to working capital and would not impact the long-term debt balance. The proforma equity balance is calculated by taking the September 30, 2005 balance and adding Net Income and Depreciation, less Dividends for fiscal years 2006 and 2007.

Q. Why was short-term debt not included in the capital structure?

A. The Company's short-term debt is used for working capital needs and not for financing of long-term capital required to provide utility service. In September, Cascade issued $15 million in long-term debt. This additional long-term debt reduced short-term debt and brought short-term debt to a balance that meets the Company's working capital needs only. Currently, short-term debt is primarily used to finance the Company's monthly gas costs. Cascade pays the majority of its gas costs on the 25th of each month. Collections from customers for the related gas are received throughout the month. The staggered collections allow Cascade to reduce the amounts borrowed on the 25th of each month related to gas payments. When the short-term debt balances are paid off, the Company accumulates cash during the remainder of the month until the next gas payments are due. Exhibit __ (MDM-5), which shows the Company's average short-term borrowing for a recent month, January 2006, has been included to demonstrate the current use of the Company's short-term debt. Exhibit ___ (MDM-5) shows that for 12 days of the month, there are no short-term borrowings and the cash balance is positive. By netting the short-term borrowings with cash invested in Money Markets in column (d) of Exhibit __ (MDM-5), the resulting

CASCADE NATURAL GAS CORPORATION
222 FAIRVIEW AVENUE NORTH
SEATTLE, WA 98109
(206) 624-3900

average daily balance for the month of January 2006 was a cash balance of approximately $293,000. This exhibit confirms that short-term debt is not regularly included as part of the Company's capital structure.

Q. Does this conclude your testimony?

A. Yes.

CASCADE NATURAL GAS CORPORATION
222 FAIRVIEW AVENUE NORTH
SEATTLE, WA 98109
(206) 624-3900