Exhibit No. ___T (MDM-6T)
Docket No. UG-060256
Witness: Matthew D. McArthur

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

CASCADE NATURAL GAS CORPORATION **Complainant,** **v.** **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION** **Respondent.**	**DOCKET NO. UG-060256**

REBUTTAL TESTIMONY OF

Matthew D. McArthur

STAFF OF

Cascade Natural Gas Corporation

Capital Structure

September 12, 2006

REBUTTAL TESTIMONY
OF
MATTHEW D. MCARTHUR
ON BEHALF OF
CASCADE NATURAL GAS COMPANY

Q. PLEASE STATE YOUR NAME, ADDRESS, AND OCCUPATION.

A. My name is Matt McArthur. My business address is 222 Fairview Avenue North, Seattle, Washington. I am the Treasurer for Cascade Natural Gas Corporation.

Q. ARE YOU THE SAME MATTHEW D. MCARTHUR WHO PREVIOUSLY FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. PLEASE DESCRIBE THE PURPOSE OF YOUR REBUTTAL TESTIMONY.

A. I am rebutting the testimony of Commission Staff witness Parcell regarding the Company's capital structure.

Q. PLEASE SUMMARIZE MR. PARCELL'S CAPITAL STRUCTURE RECOMMENDATION.

A. Mr. Parcell calculated a capital structure using a combination of December 31, 2005 balances for long-term debt and equity and a 12-month average balance ending December 31, 2005 for the short-term debt. Mr. Parcell's derived capital structure is:

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Long-term Debt	54.78%
Short-term Debt	4.09%
Common Equity	41.13%

Q. IS MR PARCELL'S BASIC APPROACH APPROPRIATE FOR DETERMINING FUTURE RATES FOR AN LDC LIKE CASCADE?

A. No. Mr. Parcell selected a single, historical point to determine the capital structure for ratemaking purposes on a going forward basis, and in doing so ignored several factors influencing that ratio. Equity ranged from 47-53% of the company's capital structure from 1996 through 2000 (see Exhibit No.__(MDM-7)). As a result of borrowing to finance substantial gas costs deferrals and substandard returns from 2001 until the present, Cascade's capital structure has deteriorated. The capital structure as of December 31, 2005 – the date selected by Mr. Parcell – is not representative of Cascade's capital structure as of today, nor of the Company's capital structure on a going forward basis. Cascade has made significant progress to improve its financial standing, which is displayed in current public data. This recent progress displays Cascade's ability to improve its capital structure to align with the industry target ratio (50% equity/50% debt) within a few years.

Q. PLEASE SUMMARIZE YOUR SPECIFIC CRITICISMS OF MR. PARCELL'S TESTIMONY.

A. I have the following specific comments:

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1. **Date of the Capital Structure.** The date chosen by Mr. Parcell to take a "snapshot" of the Company's capital structure is not representative of the Company's historical, most recent nor forward-looking capital structure.
2. **Accumulated Other Comprehensive Loss in Equity.** Mr. Parcell improperly includes the impact of Other Comprehensive Loss in Equity, or OCI, in his equity ratio determination, which results in understating the Company's equity ratio for rate setting purposes.
3. **Deferred Gas Costs or Cash balances.** Mr. Parcell did not consider the impact of carrying a Deferred Gas Cost balance on the Company's capital structure, which results in debt balances being inflated.
4. **Current Short-term Debt balances.** Mr. Parcell's capital structure includes short-term debt, which is inconsistent with the Company's current short-term debt practices.

My testimony will discuss each of these points.

DATE OF THE CAPITAL STRUCTURE

Q. WHAT WAS MR. PARCELL'S EXPLANATION FOR USING FINANCIAL DATA AS OF DECEMBER 31, 2005 FOR DETERMINING THE COMPANY'S CAPITAL STRUCTURE?

A. Staff's response to Cascade Data Request No. 6 indicates that Mr. Parcell chose the December 31, 2005 financial data because it was the most recent calendar year available.

1 **Q. WHY DO YOU DISAGREE WITH USING THE FINANCIAL DATA AS OF**
2 **DECEMBER 31, 2005 FOR DETERMINING THE COMPANY'S CAPITAL**
3 **STRUCTURE?**

4 A. A calendar year end is of no particular relevance to the Company as the fiscal year end
5 for Cascade is September 30. Also, given Mr. Parcell's approach to modeling capital
6 structure, the selection of a mid-winter date distorts the ratio to reflect seasonal gas
7 financing and precedes the recognition of Cascade's seasonal winter earnings pattern. At
8 the time of Mr. Parcell's testimony, the Company had made public financial data as of
9 March 31, 2006 and June 30, 2006. The financial balances of the Company as of June
10 30, 2006 are more recent, better reflect the actions that the Company has made to
11 improve its capital structure, and are more representative in that this date is centered
12 between its traditional negative-earning summer quarters.

13 **Q. WHAT ARE THE RECENT ACTIONS BY THE COMPANY AND HOW HAVE**
14 **THEY IMPROVED THE CAPITAL STRUCTURE?**

15 A. In light of the Company's diminishing returns and below average capital structure, the
16 Company has controlled capital spending in fiscal year 2006 to conserve cash and reduce
17 the need to borrow. This has allowed the Company to pay down a small portion of long-
18 term debt and avoid additional borrowing. At the same time, common equity has
19 increased through issuing additional shares and retaining earnings. See Exhibit No. __
20 (MDM-8) for the June 30, 2006 balances.

21

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1 **ACCUMULATED OTHER COMPREHENSIVE INCOME (OCI) IN EQUITY**

2 **Q. PLEASE PROVIDE SOME BACKGROUND REGARDING THE NATURE OF**
3 **ACCUMULATED OTHER COMPREHENSIVE LOSS?**

4 A. Accumulated OCI for the Company results from "minimum pension liability
5 adjustments" recorded pursuant to paragraphs 36-37 of FASB Statement 87, and
6 paragraphs 17 and 31 of FASB Statement 130. The entries to the OCI account stem from
7 the funded status of the pension plan, and the required balance sheet pension liability
8 relative to the funded status.

9 **Q. WHY SHOULD ACCUMULATED OCI BE EXCLUDED FROM THE CAPITAL**
10 **STRUCTURE FOR RATE MAKING PURPOSES?**

11 A. The Company's rate application properly excludes Accumulated OCI from equity in the
12 determination of capital structure and calculation of equity component of cost of service.
13 OCI should be treated differently from retained earnings as a component of equity.
14 Amounts in Accumulated OCI have not been reflected in operating expenses, and thus
15 have not been included in cost of service for ratemaking purposes. Because CNGC has
16 never received rate recognition of those costs, they are different from the Retained
17 Earnings component of equity. The amounts in retained earnings include the cumulative
18 effect of operating expenses that have been included in cost of service and have been (at
19 least theoretically) included in cost of service recovered through rates. An alternative
20 would have been to amortize these costs and recognize as operating expense for
21 regulatory accounting purposes. The net result would be an increased need for additional

1 revenue. In order to be consistent and equitable, the Accumulated OCI component of
2 equity must be excluded in the determination of costs and capital structure for ratemaking
3 purposes.
4
5 **DEFERRED GAS COSTS AND CASH BALANCES**
6 **Q. WHY SHOULD DEFERRED GAS COSTS BE CONSIDERED IN**
7 **DETERMINING THE COMPANY'S CAPITAL STRUCTURE?**
8 A. In 2000 and 2001, natural gas prices increased substantially. Rather than pass on the
9 entire increase of the gas costs to the Company's customers in 2001, the Company
10 elected, with approval from the Commission, to pro-rate the recovery of these costs over
11 the next three years. This deferral of these unexpected costs was beneficial to customers
12 as the increases in gas costs were implemented over a period of time. In subsequent PGA
13 adjustments, the Company has continued to smooth the impact of increasing gas costs to
14 customers and had not recovered all of the deferred gas costs. As a result, the Company
15 has been required to finance these costs with debt. Had the Company sought to recover
16 the entire amount of deferred gas costs more promptly instead of attempting to assist our
17 customers by spreading the historical increases over time, this debt would have been
18 lower and Cascade's capital structure would have been much closer to the target 50/50
19 ratio.
20 **Q. HOW HAVE THE DEFERRED GAS COSTS BALANCE CHANGED IN FISCAL**
21 **2006 AND WHAT WAS THE IMPACT ON CASH?**

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1 A. As of September 30, 2005, the Company had a deferred gas cost balance of $16.6
2 million. The Company's 2006 PGA includes an amortization rate (Temporary Technical
3 Alignment Tracking Application) to recover the outstanding deferred gas cost balance.
4 This amortization of the deferred gas costs has resulted in the reduction of the deferred
5 gas balance to approximately $500,000 as of June 30, 2006.
6
7 The other contributing factor to a lower deferred gas cost balance as of June 30, 2006 is
8 slightly lower gas prices since the 2005 hurricane season. With slightly lower-than-
9 expected gas prices, the Company has not incurred new deferred gas cost balances in
10 fiscal 2006.
11
12 The result of the declining deferred gas costs balance is a reduced need for debt. Based
13 on the Company's current financial position, the Company will pay down $8 million in
14 long-term debt that will be due in October 2006. The low deferred gas costs balance will
15 enable the Company to avoid further borrowings by being available to fund capital
16 investments and any other needs such as future gas cost deferrals.
17
18 **CURRENT SHORT-TERM DEBT BALANCES**
19 **Q. WHY IS MR. PARCELL INCORRECT IN CONCLUDING THAT SHORT-TERM**
20 **DEBT HAS BEEN USED TO FINANCE PART OF RATE BASE?**

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1 A. In Mr. Parcell's testimony on page 21, he states that "it is proper to include short-term
2 debt in the ratemaking capital structure when it is apparent that the Company consistently
3 maintains outstanding balances of short-term debt and/or is financing part of rate base."
4 Mr. Parcell's refers to Exhibit No. __ (DCP-3) Schedule 5 as historical support for his
5 basis.

6 Historical short-term debt balances are not related to rate base financing, however, as I will
7 demonstrate by detailing the usages of the short-term debt for the periods used in Mr.
8 Parcell's exhibit. The high short-term debt as of September 30, 2001 of $40 million was due
9 to a $40.8 million increase in deferred gas costs as mentioned above. This balance was
10 refinanced in November 2001 with long-term debt. The balance as of September 30, 2003
11 was related to working capital needs. As indicated in the Company's response to WUTC
12 Staff Data Request No. 27, the monthly average balances show that from August 2003
13 through January 2004 there was a small need for cash to cover working capital requirements.
14 This period of the Company's year typically requires more cash as it is subsequent to periods
15 of net losses (summer time) and prior to large gas purchases for the winter. The balance as
16 of September 30, 2004 was primarily incurred to pay long-term debt of $22 million that was
17 due in August 2004. This amount was held in short-term debt until January 2005 when it
18 was refinanced with long-term debt. In fiscal year 2005, the Company secured a total of $45
19 million in new long-term debt, $36 million of which was to refinance previously retired
20 long-term debt. The short-term debt balance as of September 30, 2005 was a result of poor
21 financial performance over the previous years and due to the working capital requirements

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for that time of year. In addition, the deferred gas costs increased approximately $4 million in 2005, which were financed with short-term debt.

Q. WHAT HAS BEEN THE COMPANY'S EXPERIENCE IN FISCAL 2006 REGARDING SHORT-TERM DEBT BALANCES?

A. As indicated in the Company's response to WUTC Staff Data Request No. 27, short-term debt has declined through March 2006. The Company has not borrowed any short-term debt since March 2006. The Company anticipates that it will not require any short-term debt until possibly the winter season, and in that case it would be to pay for gas costs on a very short-term, daily basis that would be inappropriate to reflect as a permanent component of the Company's capital structure.

Q. WHAT CAPITAL STRUCTURE DOES THE COMPANY RECOMMEND FOR RATEMAKING PURPOSES?

A. As previously discussed in my direct testimony on pages 2 and 3 and in Dr. Morin's direct testimony on pages 53 and 54, the Company recommends that a capital structure of 50% common equity capital and 50% long-term debt capital be used for purposes of determining the Company's overall rate of return in this proceeding. This capital structure is the industry norm, is consistent with the ROE testimony of Dr. Morin, and will preserve the Company's financial integrity. In addition, based on June 30, 2006 financial balances, the Company is moving towards the proposed capital structure, and thus reflects the capital structure that is likely to be achieved during the rate-effective period.

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1 **Q. PLEASE EXPLAIN EXHIBIT ___ (MDM-8) AND THE COMPANY'S VIEW OF**
2 **ITS CAPITAL STRUCTURE AS OF JUNE 30, 2006.**
3 A. The Company's capital structure as of June 30, 2006, as shown in Exhibit No. ___
4 (MDM-8), is 55% long-term debt and 45% common equity. As explained above, some
5 of the debt has been incurred to cover the deferred gas costs balances. Because this debt
6 was not used for the increase in rate base, it should be excluded. The cash generated
7 from the recovery of deferred gas costs will be used to avoid future debt and will result in
8 debt reductions, including the scheduled pay down of $8 million in long-term debt in
9 Cascade's next fiscal year. Therefore, the June 30, 2006 cash balances and deferred gas
10 costs should be netted with the long-term debt in determining the capital structure for
11 ratemaking purposes. After applying these two adjustments to debt, cash balance and
12 deferred gas cost balances, the resulting capital structure is 52% debt and 48% common
13 equity. This schedule demonstrates that the Company is moving quickly toward a 50%
14 equity ratio.
15 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**
16 A. Yes, it does.
17

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EXHIBIT TO REBUTTAL TESTIMONY OF

Matthew D. McArthur

STAFF OF

Cascade Natural Gas Corporation

Capital Structure

September 12, 2006

Exhibit ___(MDM-7) Capital Structure
Exhibit ___ (MDM-8) Historical Capital Structure

Cascade Natural Gas Corporation
HISTORICAL CAPITAL STRUCTURE

Line #	Description		9/30/1996	9/30/1997	9/30/1998	9/30/1999	9/30/2000	9/30/2001	9/30/2002	9/30/2003	9/30/2004	9/30/2005	6/30/2006
	(a)		(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)
	Capital Ratios												
1	Debt		46.8%	53.1%	52.0%	50.9%	49.3%	54.3%	56.8%	57.4%	57.5%	58.7%	55.1%
2	Equity	1/	53.2%	46.9%	48.0%	49.1%	50.7%	45.7%	43.2%	42.6%	42.5%	41.3%	44.9%
3	Total Capital		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

1/ Equity includes both Common Equity and Preferred Equity. The Company carried Preferred Stock balances from 1996 to 2000. The Common Equity is adjusted for Accumulated Other Comprehensive Income (Loss).

Docket No. ____________
Exhibit (MDM-8)
Schedule 1 of 1
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Cascade Natural Gas Corporation
CAPITAL STRUCTURE

Line #	Description	Amount	Ratio
	(a)	(b)	(c)
		6/30/2006	
1	LT Debt (including current)	173,333	55.1%
2	ST Debt	-	0.0%
3	Equity	128,081	
4	less OCI	13,103	
5	Net Equity	141,184	44.9%
6	Total Capital	314,517	100.0%
7	Adjusting Items		
8	Cash Balance	22,364	
9	Deferred Gas Costs	527	
10	Adjusted Debt for Cash and Deferred Gas Costs		
11	Debt	150,442	51.6%
12	Equity	141,184	48.4%
13	Total Capital	291,626	100.0%